Financial Conduct Authority (FCA) Consultation Paper CP21/36
A new Consumer Duty

Submission by The Financial Inclusion Centre

February 2022

About The Financial Inclusion Centre

The Financial Inclusion Centre (FIC) is an independent, not-for-profit policy and research group (www.inclusioncentre.org.uk). The Centre's mission is to promote a financial system and financial markets that work for society. The Centre works at two main levels:

Promoting system level change

Research and policy development to promote sustainable, resilient, economically and socially useful financial markets that: benefit the environment; encourage responsible corporate behaviours and create a positive social impact; and efficiently allocate long term financial resources to the real economy.

Ensuring households' core financial services needs are met

Promoting fair and inclusive, efficient and competitive, well-governed and accountable, properly regulated financial markets and services that meet households' core financial needs. We do this by undertaking research into the causes of market failure in the sector, formulating policies to address that market failure, developing alternative solutions where the market cannot deliver, and campaigning for market reform. We focus on households who are excluded from, face discrimination in, or are underserved by financial markets and services.

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RESPONSE TO QUESTIONS

Q1: Do you have any comments on the proposed scope of the Consumer Duty?

We supported the FCA's original intention expressed in CP21/13 that the scope would include all retail clients. A single standard definition of retail client would bring much needed clarity and consistency to regulation. It is very difficult for consumers (including SMEs) to understand the boundaries of the regulatory perimeter and, therefore, what consumer protections apply.

Therefore, we are disappointed that CP21/36 proposes to align the scope of the Consumer Duty with the existing scope of the sectoral sourcebooks. This retains the unnecessary complexity and confusion in the current system.

Even at this stage, we urge the FCA to introduce a single standard definition of client which should incorporate retail consumers, SMEs, and a category of *non-professional clients* such as pension fund trustees, local authorities, and charities.

We reiterate our view that clients such as pension funds, local authorities, and charities should be considered non-professional. These clients are vulnerable to misselling. Indeed, the risks and harm can be greater given the nature of the fiduciary responsibility held by these groups. For example, pension fund trustees act in the interests of large numbers of pension scheme members. They are vulnerable to misselling from investment consultants. The impact of misselling can be significant given the sums of money under their direction.

We support the intention to include prospective clients. Much of the detriment we see in financial services occurs as a result of practices at the promotion and marketing stage. This has taken on greater significance with the increased use of digital and data services to exploit consumers' psychological and behavioural biases.

It is not clear from CP23/36 how the Consumer Duty would apply to firms that do not have Part IV FSMA permissions and exempt from elements of regulation such as the Senior Managers and Certification Regime (SM&CR). We would urge the FCA to introduce equivalent measures for firms not fully subject to the proposed Consumer Duty.

Q2: Do you have any comments on the proposed application of the Consumer Duty through the distribution chain and on the related draft rules and non-Handbook guidance?

We support the proposal to apply the Consumer Duty 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.

We also support the proposal to apply the Consumer Duty to unregulated activities which are ancillary to regulated activity.

We would welcome clarification on the application of the Consumer Duty to digital services firms including Big Tech platforms and information intermediaries. These firms now play an instrumental role in the design (including pricing strategies) and distribution of retail financial products and services. They are involved in:

- manufacturing demand for financial products
- facilitating access to consumer credit (eg. buy now, pay later) to enable purchase of other consumer products and goods
- influencing consumer understanding of, and attitudes to, products and services
- providing access to hyper targeted market research focusing on individual consumer profiling rather than group profiling (processing capacity means that hyper targeted profiling can now actually be undertaken on a mass market basis)
- allowing financial firms and intermediaries to target individual consumers, to track and exploit behavioural and psychological biases
- product development and distribution through real time feedback loops and big data

We are concerned that this ***intersection*** between financial and digital services is poorly regulated. Digital services firms are not regulated to the same standards as financial services firms. There is a risk that boards and senior managers of regulated financial firms and intermediaries are delegating too much responsibility for the above functions to poorly regulated digital services firms.

As well as clarification on how the Consumer Duty applies to digital firms, the FCA should issue clear guidance for boards and senior managers of regulated firms to ensure they pay more attention to the risks created by the use of digital and data services in financial product design, promotion, and distribution.[1]

We do not agree with the statements on occupational pensions. It is appropriate that the Pensions Regulator should have lead responsibility on the prudential and governance standards relating to pension schemes. But, the FCA's proposed Consumer Duty should apply to firms such as asset managers and investment consultants who sell services to pension fund trustees.

We have no objection to firms providing IT services to regulated firms not being subject to the Duty.

The FCA is proposing to require UK distributors of non-UK products and services to take all *reasonable* steps to comply with the products and services outcome. The FCA should issue clear guidance on what 'reasonable' means in this case. Moreover, it is not clear why this duty should apply only to the products and services outcome. This should apply to the consumer understanding and support outcomes.

Consumers need to be made aware of the risks associated with buying non-UK regulated products and services. Similarly, if UK regulated firms opt to use non-UK firms they should be required to provide additional support in the event of misselling or administrative failures.

[1] As an aside, FIC argues that we need a Digital Conduct Authority (DCA) to complement the work of the FCA.

Regulated firms can facilitate access, and provide a 'halo effect', to providers, intermediaries, products, and activities which might fall outside the regulatory perimeter.[2] The FCA should emphasise that the proposed enhanced Consumer Duty applies to non-regulated activities where the regulated firm has an influence over consumer behaviour and decision making. Boards and senior managers of regulated firms must pay much more attention to activities that are not regulated by the FCA, but which are integral to the design, promotion, and distribution of regulated financial products.

Another emerging risk concerns the manufacture, marketing, and distribution of ESG products (including the repackaging and rebranding of non-ESG products). Third-party information intermediaries and ratings agencies are expected to play a significant role in the marketing and selling of ESG products to consumers.

But, these intermediaries and ratings agencies are largely unregulated. There is a clear risk that regulated financial product providers and intermediaries will select third party providers with the least onerous rating standards. It is not reasonable to expect consumers to be able to establish the integrity of third party ratings.

It is to be hoped that the FCA will soon regulate these third party intermediaries and agencies. Until then, the FCA should protect consumers by making it clear that, as part of the Consumer Duty, regulated financial providers and intermediaries must exercise due diligence when selecting third party providers of ESG information and ratings. The steps they have taken to check the integrity of third party ESG information and ratings should form part of the FCA's Consumer Duty supervision regime.

We are concerned that the proposals in CP21/36 do not place enough weight on the need for firms and others in the market to treat consumers fairly throughout the *whole* of the firm/ customer relationship especially when consumers might be in difficulty.

An example of this, relates to the very low level of county court judgments (CCJs) that are marked as 'satisfied' on the Register of Judgments. It is not common knowledge that CCJs are marked as satisfied only if the debt is repaid ***and*** proof of payment is supplied to the courts in England and Wales (and to Registry Trust for other jurisdictions). This problem could be addressed by the FCA and other regulators[3] requiring creditor firms within their remit to notify the courts when a debt has been repaid as part of treating customers fairly obligations (and now as part of the proposed Consumer Duty).

Ensuring CCJs are marked as satisfied is a small step that could have a big impact on consumers' financial health and wellbeing. It could help consumers rebuild their finances and bring them back into the mainstream financial system - this will take on even greater significance as the economy recovers from the effects of the Covid economic crisis.

[2] See, for example, the Gloster Report into the regulation of London Capital & Finance (LCF) Gloster_Report_FINAL.pdf (publishing.service.gov.uk)
[3] Such as OFGEM, OFWAT, and OFCOM

Importantly, this failure to ensure CCJs are marked as satisfied could actually prevent other firms that wish to offer better value products to those consumers who have paid a CCJ. This not just has implications for access to fair and affordable products but can undermine effective competition.

It is unclear how the Consumer Duty might apply to situations where regulated firms have sold on outstanding consumer debts to FCA authorised third party debt purchasers or collection agencies, to third parties not authorised by the FCA, or to regulated debt purchasers or collection agencies which administer or buy non-regulated debt. The original firm should not be able to offload the responsibility for dealing with the harm originally created by their activities. We would welcome clarification on these issues.

Q3: Do you have any comments on the proposed application of the Consumer Duty to existing products and services, and on the related draft rules and non-Handbook guidance?

We support the intention to apply the proposals to i. existing products and services; and ii. products or services sold or renewed after the Consumer Duty comes into effect.

But, we are concerned about the FCA's approach to closed products. Closed products such as insurance based personal pensions continue to cause harm to consumers with high charges, low net returns, and punitive exit penalties which mean that consumers continue to be, in effect, locked into these products. We would argue, therefore, that firms should be required to review closed products to assess what remedial action can be taken to protect consumers from further harm and report to the FCA on how they intend to redress the harm caused.

Q4: Are there any obstacles that would prevent firms from following our proposed approach to applying the Consumer Duty to existing products and services?

We are not aware of any obstacles that would prevent firms from following the proposed approach.

Q5: Do you have any comments on the proposed Consumer Principle and the related draft rules and non-Handbook guidance?

With regards to the wording of the Consumer Outcome, as we said in our response to CP21/13, it is not clear which of the two formulations proposed would best reflect the proactive focus on consumer interests and outcomes.

It would have been helpful to have a number of scenarios of potential consumer detriment with an explanation of how the FCA would expect firms to respond under the two different formulations. The FCA has still not provided clear scenarios to illustrate the difference in impact between the two different wordings.

Nevertheless, of the two options:

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

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

we still take the view that the second is the stronger and clearer.

The FCA states that its focus is on firms acting *reasonably* to deliver good outcomes. But, it is not clear what this might mean in practice. In our response to CP21/13 we raised the example of firms selling high cost products in a market where high costs are the norm.

The overdraft market is a case in point. Quoted rates for new overdrafts stand at 34% compared to the 10 year average of 22%.[4] There appears to be no good reason for this significant increase especially as the FCA recently introduced rules to try to promote competition in the market. With the FCA's approach, a firm providing overdrafts at these high rates could be considered to be acting reasonably because the rest of the market was providing overdrafts at these high rates.

Therefore, the FCA should make it clear, in the guidance, that acting reasonably must be judged on its own terms not according to what is standard pricing practices and levels in the market.

The FCA reiterates the point that the new proposals do not mean that consumers can or will be protected from all harm or remove the principle of consumer responsibility. This approach is only reasonable if it is clear that firms (who are in a position of power in the financial relationship) have met the requirements of the Consumer Duty.

Ideally, the consumer responsibility defined in legislation[5] should be amended to say that the principle of consumer responsibility applies if firms have taken necessary steps to comply with the relevant regulatory requirements (in this case the Consumer Duty requirements). In the meantime, FCA should make this clear in regulatory guidance.

Q6: Do you agree with our proposal to disapply Principles 6 & 7 where the Consumer Duty applies?

Yes. This is a good opportunity to streamline the Handbook and to reduce the level of complexity where feasible. But, this should not be limited to Principles 6 and 7.

Q7: Do you agree with our proposal to retain Handbook and non-Handbook material related to Principles 6 and 7 should remain relevant to firms considering their obligations under the Consumer Duty?

No. It is positive that the FCA states that the Consumer Principle imposes a higher standard of conduct than Principles 6 and 7. But, Handbook and non-Handbook material is also important for ensuring that firms interpret regulatory expectations in the correct way. Therefore, if the FCA wants the Consumer Duty to have the full effect, it should review and upgrade the Handbook and non-Handbook material as soon as is practicably possible.

[4] Financial Inclusion Centre analysis of Bank of England data on quoted household interest rates
[5] See s3B(1)(d) FSMA 2000

Q8: Do you have any comments on our proposed cross-cutting rules and the related draft rules and non-Handbook guidance?

In our submission to CP12/13 we raised concerns that the phrases 'reasonable expectations' and 'causing foreseeable harm' are likely to be open to abuse by firms and intermediaries, and allow firms and intermediaries to challenge the FCA's efforts to apply the overarching duty and principle.

We welcome the FCA's decision to remove the reference to 'all reasonable steps'. But, the FCA retains the concepts of reasonableness, foreseeable harm, and reasonably foreseeable.

It would be more effective if the FCA required firms and intermediaries to adopt the ***precautionary principle*** when determining whether products and practices are likely to cause harm. Firms and intermediaries, with all the huge financial and technology/ data resources at their disposal, are well placed to determine the likelihood of harm resulting. They should be required to take steps to proactively prevent or minimise harm occurring, and report to the FCA on how they have done this.

Retaining the concept of reasonableness as interpreted in common law could lead to confusion and uncertainty, and is unlikely to drive up standards. Reasonableness is determined by what is considered to be acceptable practice at the time. Yet, as we have explained elsewhere, it could be deemed reasonable for firms to keep applying high charges on products if those high charges were in line with typical market prices.

The FCA might say that the pressure of competition will prevent this. But, this is not realistic. Competition as a force for limiting consumer harm is not very effective in key sectors of financial services.

Indeed, fierce competition can increase the risk of harm as providers compete to acquire business. Acquisition costs can have the effect of pushing up prices. The dynamic of competition can compel providers to use harmful marketing practices to persuade consumers to buy their products or services (made easier by the adoption of digital and data based market research and advertising practices).

The aggressive-competition dynamic is the main cause of harm in financial services. This is what a new Consumer Duty must seek to constrain. If the Consumer Duty is to make markets in financial services work better for consumers, it must set new, objectively higher standards. It should not embed and retain unreasonable or aggressive practices in dysfunctional markets.

Q9: Do you have any comments on our proposed requirements under the products and services outcome and the related draft rules and non-Handbook guidance?

We support the proposals for manufacturers and distributors. This includes some important measures such as: an approvals process, better identification of target markets (including those with vulnerabilities), testing products and services, selecting distribution channels, regular reviews, and requiring distributors to obtain information from manufacturers to understand products and services. These should make a useful contribution to pre-empting and mitigating the effects of harm.

However, this should be strengthened further. In CP21/13 the FCA used the phrase '*consumers reasonably* expect'. Reasonable expectations are, by definition, influenced by prior experience. As we explain above, if the market overall manufactures and sells products and services that are poor standard and value, then consumers will be accustomed to receiving poor value.

They will not have had the opportunity to experience better products and services. Therefore, the FCA should make it clear to firms that they cannot claim they are delivering what consumers reasonably expect just because they are selling what is standard in the market.

As mentioned above, it would be more effective if the FCA required firms to adopt the precautionary principle when determining whether products and practices are likely to cause harm.

We are particularly concerned about the increased use of digitalisation and digitisation in financial services. The FCA should issue clear guidance for boards and senior managers of regulated firms to ensure they pay more attention to the risks created by the use of digitalisation and digitisation in financial product design, promotion, and distribution. This is particularly important when it comes to the use of technology and big data to target vulnerable consumers and exploit behavioural biases ***pre*** sale.

The FCA states that its proposals do not amount to product regulation, that it is not setting minimum requirements for products to meet in different sectors, and will not approve products before they are launched (other than those where it already has this role).

It is very unfortunate that the FCA has not taken this opportunity to make greater use of product regulation such as price capping and product approval. Direct interventions such as price caps have been shown to be a much more effective method for constraining harmful market practices and dealing with market inefficiencies than indirect methods such as promoting competition or tackling information asymmetries.

With regards to financial inclusion and access, the FCA would appear to conflate this with consumer vulnerability. These are separate, albeit connected, issues. Vulnerable consumers can still have access to the market (although of course the terms on which they have been granted access may be unreasonable or unfair). Nevertheless, they still have access in principle. Excluded consumers do not have access on any terms because the market is unable or unwilling to serve them.

We agree that the FCA's proposals should not restrict access. Arguments made by industry lobbies that robust regulation and rules contribute to financial exclusion are disingenuous. But, the FCA cannot rely on competition to drive through efficiencies and therefore improve access to excluded consumers.

In our response to HMT's Financial Services Future Regulatory Framework Review, we proposed that the FCA should be given a new statutory objective to promote ***fair access*** to financial services. We appreciate that the FCA is not a social policy regulator. It is for Parliament and government to mandate policy solutions where markets fail to deliver.

But, even with these limitations, there is much the FCA can do to promote inclusion. In particular, the lack of data and information is holding back efforts to promote financial access and inclusion. To support our fair access objective, we argued for a rethink on the type and relevance of data published on market access and inclusion.

In the UK, financial services firms have few meaningful obligations with regards to financial inclusion. There is almost no transparency on how well financial services providers are performing in relation to financial inclusion or the extent to which financial practices can result in outright discrimination against vulnerable groups.

Even equality impact assessments provide few usable insights into how well markets meet the needs of, or the potential impact of policy interventions on, consumers with protected characteristics.

The approach in the UK is contrast to the obligations faced by US financial institutions under the Community Reinvestment Act (CRA)[6] and Home Mortgage Disclosure Act (HMDA).[7]

Similarly, the potential for the Consumer Duty to have a positive impact on market behaviour will be undermined unless the FCA:

i. specifies the metrics that firms must use to measure compliance with the Consumer Duty; and
ii. requires firms to report to the regulator on compliance performance.

Therefore, to support the product and services outcome, we propose that:

- the FCA should produce regular reports on how well markets are meeting the needs of consumers (based on the established consumer outcomes – see Q17 below);
- the FCA should produce regular audits of how well the financial services industry is complying with the Consumer Duty;
- the FCA should produce regular financial inclusion audits assessing the performance of the industry (and sectors) against financial inclusion metrics with a special focus on households with protected characteristics;
- the FCA should report to Parliament and government on the extent to which commercial financial services is able to meet the needs of vulnerable and excluded groups (especially those with protected characteristics);
- the FCA should report to Parliament and government on the impact of policy decisions on financial inclusion – for example, changes to the Universal Credit system; and
- individual firms should be required to produce financial inclusion audits similar to the US CRA and HMDA.

Q10: Do you have any comments on our proposed requirements under the price and value outcome and the related draft rules and non-Handbook guidance?

We remain concerned about the price and value outcome as envisaged by the FCA in CP21/36. We do not see this making a real difference to consumer outcomes in terms of lower prices and better value.

[6] Community Reinvestment Act (CRA) | OCC
[7] The Home Mortgage Disclosure Act | Consumer Financial Protection Bureau (consumerfinance.gov)

There is a worrying lack of ambition shown by the FCA on the price and value outcome. And it is not clear why the FCA remains so reluctant to use tried and tested, product interventions such as price caps.

As with the product outcome discussed above, we are unclear as to what the FCA will seek to do with the price and value outcome. The FCA talks about: '*products and services that do not represent fair value, where the benefits consumers receive are not reasonable relative to the price they pay'*. But, it is not clear what is meant by *fair value* or *reasonable* relative to the price paid.

Competition theory holds that products are fairly priced and represent good value if product margins are low (the theory is that market forces compete away high margins). But, in key market sectors, product margins may be low, yet the product still offers poor value for consumers – because the market overall is inefficient.

Firms do not necessarily compete for consumers' business; they compete for distribution or have to spend large sums on advertising and promotions. The fiercer the competition the higher the costs spent on acquiring distribution channels and/ or advertising and promotions – which pushes up end-to-end product costs.

In this case, the final price paid by the consumer may represent fair value from the *provider* perspective (as margins are low). But, the products would not represent fair value for *consumers*. With the FCA's approach to the price and value outcome, a firm selling a high price product may be considered to be offering a fair price and value because the rest of the market is doing so. So, the FCA's approach risks embedding existing market inefficiencies, high prices and poor value.

The payday lending market was an example of this. Payday lenders used to argue that costs were so high because of the higher risk associated with the target market. They argued the price was fair value. But, the poor value and detriment was intrinsic to the payday lending business model. Competition and price discovery were inefficient mechanisms for protecting consumers and ensuring they received a fair deal.

In other cases, there may be a significant amount of choice (so it looks as if there is plenty of competition in the market), but industry margins are high. In this case, significant value is extracted from consumers and the products on the market generally offer comparatively poor value.

An example of this is actively managed investment funds. It is genuinely difficult to see how actively managed funds (which tend to have higher prices) represent fair value if there are passive funds with similar investment objectives available. In this case, would the FCA expect asset management firms to reduce prices or not sell products, or advisers and platforms to not recommend products?

There have been examples in the past where a properly enforced price and value outcome might have had a positive impact. The FCA in its ground-breaking study on the dysfunctional overdraft market[8] found that vulnerable consumers (including those on very low incomes and with protected characteristics) were paying significantly more for overdrafts than better off counterparts - even though technological developments meant that such a high 'risk premium' was no longer justified.

In our view, this was clear discrimination and exploitation. The FCA refused to take enforcement action against the banks involved. A price and value outcome could have been used to prevent this. But, leaving it to banks to interpret what a fair price and value meant would not have been the most effective way of protecting vulnerable consumers. A more efficient method would be for the FCA to

[8] FCA confirms biggest shake-up to the overdraft market for a generation | FCA

instruct banks not to behave like this and/ or to use price caps which, as we know, have been shown to be more effective than markets policing themselves.

Generally speaking, the FCA is rather optimistic about the potential for competition to deliver fair prices and value. Consumers, especially vulnerable consumers, cannot afford yet another experiment with competition as the primary means of delivering these outcomes. It is not sensible to allow individual firms and the market generally (through competition and price discovery) to be the arbiter of what constitutes fair value. The FCA will have to be more prescriptive on what a fair price and value means.

So, the question is: how best to determine fair prices and value, and ensure the needs of vulnerable consumers are met? There are three complementary interventions which can be applied:

- **Price caps and product regulation:** as mentioned elsewhere, price caps are a proven mechanism. These must be a first resort rather than a last resort for the FCA. The essence of price caps is that independent assessment, not inefficient market forces, determines what is the benchmark for fair value and price. This is particularly important when it comes to essential financial services such as banking.
- **Transparency:** the FCA wants firms to justify the price offered to vulnerable groups in terms of fair value. We support this intention. But, this begs the question of how will we know whether firms are doing this in a fair way? The FCA should prioritise supervision of fair value assessments within firms as part of its ongoing general supervisory activity. Critically, we would urge the FCA to require firms to publish these assessments as part of annual Financial Inclusion Reports – see Q9.
- **FCA reports and recommendations to Parliament and government:** we appreciate that the FCA is primarily a market regulator, not a social policy regulator. Where markets are unable to meet the needs of vulnerable consumers on fair terms, it should be primarily a matter for Parliament and government to address by ensuring availability of alternative products and services. Nevertheless, the FCA could aid this process by making formal reports and recommendations to Parliament and government when it concludes that i. the market is unable to meet the needs of vulnerable consumers; and ii. that social policy interventions are needed – see Q9.

Q11: Do you have any comments on our proposed requirements under the consumer understanding outcome and the related draft rules and non-Handbook guidance?

We support in general the proposed requirements under the consumer understanding outcome. However, we would welcome further clarification on what the FCA intends to be understood by the term *average consumer* used in the guidance. What benchmark does the FCA suggest should be used to judge what constitutes the 'average' consumer?

Moreover, by definition, many consumers will have less understanding of financial matters than the 'average' consumer, others will have more understanding. The FCA should make it clear that testing the level of consumer understanding in the target market using the 'average' consumer as a benchmark would not be enough to comply with the expectations conveyed in this outcome.

More importantly, the proposals in CP23/36 say little about the use of digital and data services which are now core to the design, marketing, and distribution of financial products and services – see Q2.

The FCA states that it does not expect firms to tailor all communications to meet the needs of each individual consumer. This is reasonable. We would not expect firms to engage with and assess the level of understanding of each and every consumer.

But, the digital world is very different to the analogue world. Observing actual consumer behaviours is the best way to measure consumer understanding of products and services. And firms, through the use of digital services and big data, now have the capacity to analyse the behaviours of vast numbers of consumers on an almost real-time basis. They are able to identify patterns which can show that product design and marketing practices are causing harmful consumer behaviours.

Firms should be required to test the impact of digital marketing techniques on consumer behaviours and take remedial action where there is evidence that these techniques are causing consumers to behave in a suboptimal way.

Q12: Do you have any comments on our proposed requirements under the consumer support outcome and the related draft rules and non-Handbook guidance?

We support the proposed requirements under the consumer support outcome. We particularly welcome the FCA's intention that it should be as easy to exit a product as it is to enter.

However, further emphasis is needed on supporting consumers who are in financial difficulty. As explained above, a good example of this relates to the very low level of county court judgments (CCJs) that are marked as 'satisfied' on the Register of Judgments. This problem could be addressed by the FCA and other regulators[9] requiring creditor firms within their remit to notify the courts when a debt has been repaid as part of treating customers fairly obligations (and now as part of the proposed Consumer Duty).

Q13: Do you think the draft rules and related non-Handbook guidance do enough to ensure firms consider the diverse needs of consumers?

Q14: Do you have views on the desirability of the further potential changes outlined in paragraph 11.19?

In principle, the draft rules and related non-Handbook guidance should improve the level of consideration given to the diverse needs of consumers.

But, as explained above, additional measures are needed to deal with the harms caused to vulnerable consumers through the use of digital services and big data.

[9] Such as OFGEM, OFWAT, and OFCOM

Critically, it will not actually be possible to establish whether rules will make a difference to vulnerable consumers because of the lack of meaningful requirements on performance metrics and reporting, and the approach used by the FCA to conduct cost benefit analyses (CBAs) – see Q9, Q17, and Q19.

Q15: Do you agree with our proposal not to attach a private right of action to any aspects of the Consumer Duty at this time?

No. We do not understand the logic of the arguments put forward by the FCA.

Of course, we agree that the existing redress framework will remain the more appropriate route for almost all consumers to seek redress. Consumers can indeed pursue redress in a way that is low cost and consumer friendly. Moreover, it is encouraging that the FCA is working with FOS to improve awareness of redress schemes.

But, none of this negates the argument for a PROA. A PROA can only act as a further deterrent against poor corporate behaviours and practices.

The FCA's decision to not allow a PROA is also likely to limit the opportunity for collective redress in the form of class actions.

Q16: Do you have any comments on our proposed implementation timetable?

Allowing firms until end of April 2023 to fully implement the Consumer Duty would seem reasonable. However, we would urge the FCA to publish a schedule for firms to follow to ensure that the timetable does not slip.

Moreover, there are some elements of the work which the FCA could begin immediately such as requiring creditors to inform the courts when a CCJ has been settled (see Q2) and developing performance metrics to judge the success of the Consumer Duty (see Q9).

Q17: Do you have any comments on our proposed approach to monitoring the Consumer Duty and the related draft rules and non-Handbook guidance?

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.

Furthermore, ***if asked*** [our emphasis], the FCA would expect firms 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.

Moreover, 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.

In principle, these are positive proposals. But, we have very serious concerns. The FCA is delegating far too much responsibility to firms' boards to 'mark their own homework'.

Firstly, any report that goes to the board or equivalent management body should be independent and published. It is not tenable to allow boards or management bodies to determine who conducts a report and to keep that report confidential.

Moreover, we do not understand why the FCA is not requiring firms to report on specific metrics. This will make it more difficult to gather information on a consistent basis to allow for meaningful comparisons.

But, the most worrying aspect is that the FCA does not intend to introduce new requirements for firms to regularly report information on compliance with the Consumer Duty. The FCA would expect firms to collect suitable data and information to assess consumer outcomes for themselves, and be able to give the FCA evidence of such actions ***if requested*** [our emphasis] by the FCA.

The FCA's refusal to require firms to report on compliance, and instead rely on requesting information, will make it more difficult for the regulator itself to obtain performance data and metrics.

We are at a loss to understand the FCA's thinking on this. The FCA states that: '*Following its introduction, the Consumer Duty would be an integral part of our regulatory toolkit. We would increasingly focus on firms demonstrating the outcomes consumers are getting. This would support us in becoming a more* ***data-led*** *[our emphasis] regulator and allow us to more quickly identify practices that cause poor consumer outcomes. We would identify and focus on practices that adversely affect consumer outcomes at an* ***earlier*** *[our emphasis] stage, before harm becomes widespread*.'[10]

The Consumer Duty is a flagship reform. Relying on intermittent and inconsistent data (or after-the-event thematic reviews and market studies) is an inefficient way to identify detriment at an early stage and to monitor the effectiveness of the Consumer Duty. This cannot be said to be in keeping with a regulator that wants to be 'data-led' and proactive.

Moreover, it will make it very difficult for external stakeholders (including Parliament) to identify whether the Consumer Duty is having the intended effect. It undermines regulatory and corporate accountability.

[10] Para 14.25

External stakeholders (including Parliament) need to be able to measure how effectively regulators use their available powers, resources, and interventions to produce improvements in consumer outcomes, or prevent negative outcomes. That is why regulators exist – to make markets work for consumers, not to create conditions for market participants.

For stakeholders to monitor regulatory effectiveness requires meaningful, relevant performance data and metrics. Data and metrics can be grouped into three categories:

- input (eg. availability of financial resources, number of staff);
- output (eg. level of activity, numbers of decisions made, use of resources); and
- most importantly, outcome data and metrics (on whether interventions make markets work from the consumer perspective, not from the industry perspective).

There is quite an amount of input and output data available in publications such as business plans, annual reports, and on regulators' websites.

Data and information on the effectiveness of specific interventions can be made available, for example, through independent reviews. And there is some data and metrics on consumer outcomes and market performance made available when the FCA conducts thematic reviews and market studies. But, as mentioned, these by definition are reactive, after-the-event studies and focus on a specific issue rather than overall market performance.

In some cases, the effectiveness of the regulators can be judged by *observation*. The FCA has clearly been successful in improving corporate behaviour in retail financial services as can be observed in the reduction in widespread systemic misselling scandals.[11]

The FCA is now implementing a data strategy to improve the way it uses historical data and intelligence to better understand harm and manage it more swiftly.[12] This is positive.

But, none of the above allow for objective, *regular* monitoring and assessment of how well markets are delivering for consumers – and therefore how well the regulators' are using interventions to deliver on their statutory objectives.

If markets are working for consumers they should produce the right consumer outcomes.[13] But, it is not possible to judge how well financial markets and individual sectors[14] are delivering against the outcomes because regulators do not produce the relevant data and metrics on a systematic, consistent basis.

Therefore, it is difficult for Parliament and wider civil society to scrutinise the regulators. It must be said that, under the current reporting framework, we cannot actually tell how well the FCA is performing due to the lack of published data and metrics on what matters most – how well markets are delivering against the consumer outcomes.

[11] These still occur. The defined benefit transfer misselling scandal is a case in point. But, the number and scale of system wide misselling scandals have been reduced.
[12] Data | FCA
[13] access to products and services that meet consumer needs (economic and social utility of products and services); affordability and value for money; quality of products and services; fair treatment of consumers; security of products and services; access to appropriate information and advice; and rights to redress.
[14] banking, mortgages and consumer credit, savings, investments and pensions, insurance, and financial advice/ information provision

We fear that the effectiveness of the Consumer Duty as a flagship intervention will be undermined by the failure to require firms to report to the FCA using consistent metrics, and for the FCA to not publish those metrics.

The Consumer Duty provides the ideal opportunity for the FCA to implement a proper performance measurement framework using consumer outcome data and metrics. The FCA wants the Consumer Duty to herald a step change in how firms treat consumers. We welcome this. But, this should also be an opportunity for the FCA to fundamentally change its attitude to transparency and holding markets to account. Greater market transparency is an aid to better policy making, and driving up standards of behaviour and practices in markets. It is an aid to regulatory accountability and therefore better regulation.

Q18: Do you have any comments on our proposal to amend the individual conduct rules in COCON and the related draft rule and non-Handbook guidance?

In addition to concerns about the FCA's approach to monitoring and reporting (see above), we have concerns about the FCA's attitude to supervision and enforcement. The FCA states that: '*We agree that we have **a** [our emphasis] central role in the successful embedding of the Consumer Duty, though it will of course remain a firm's responsibility to ensure it is meeting the requirements of the Consumer Duty at all times.'*

It is the responsibility and duty of the FCA to ***make*** markets work, not to try to create the conditions for markets to work.

If the Consumer Duty is to work, the FCA must impose high standards of governance and accountability on boards of financial firms and collect, analyse, and publicise the appropriate data and metrics (see above) to hold boards to account.

It is positive that the FCA will embed the Consumer Duty as part of the Gateway assessment for retail permissions. It is also appropriate that the FCA would also expect firms to demonstrate how they would monitor consumer outcomes after authorisation. But, again, the absence of consistent reporting data and metrics will lessen the effectiveness of this requirement.

Using multi-firm or thematic studies will be helpful for understanding in more detail why failures to comply with the Consumer Duty are occurring. But, establishing consistent reporting frameworks, requiring firms to report to the FCA, and the regulator publishing that data and metrics, would enable external stakeholders to scrutinise markets. This would allow for more efficient identification of detriment and harm, which in turn would enable better use of multi-firm and thematic studies.

With regards to governance and accountability, reports to boards should be produced by independent reviewers not by internal staff. These reports should be provided as a matter of course to the FCA and made public.

Furthermore, we recommend that a named board level individual (for example, chair of an audit and risk committee) be made responsible for ensuring monitoring of compliance with the Consumer

Duty. This should be included as part of the tests of fitness and propriety for Senior Management Functions.

Q19: Do you have any comments on our cost benefit analysis?

We are not in a position to comment on the costs element of the CBA. Although we would say that the standards set out in the Consumer Duty are no higher than the standards we would expect from well run firms that operate with integrity. Firms that are already well run, by definition, will face lower transition costs. Those that are not already well run will face higher costs. That is as it should be.

The FCA states that: '*firms may face potential loss in profits due to changes they make to their product design and prices, but this loss of profits should be transferred to consumers*.'

Presumably, the FCA believes that the pressure of competition will work to ensure that firms do not transfer these costs to consumers.

This is a rather optimistic view given the historic multiple failures of competition to protect consumers in retail financial services. Preventing these costs being passed on will require robust supervision and enforcement. But, as we explain, we have very real fears that the FCA's approach to monitoring and supervision will undermine the effectiveness of the Consumer Duty as a flagship intervention. And as explained above, price caps would be a more effective method of preventing firms passing on higher costs to consumers.

We have a general concern about the way the FCA conducts CBAs. At the risk of oversimplification, FCA's approach can be summarise as one where the regulator publishes an assessment of the potential impact of its preferred interventions against the impact of 'doing nothing'.

But, it is not required to publish, as a matter of course, an assessment of potentially more effective interventions it has rejected.

A good example relates to the use of direct, effective interventions such as price caps. Yet the FCA, by default, tends not to opt for price caps (and the FCA has again rejected the wider use of price caps and product regulation this time to ensure the Consumer Duty is effective). It sees direct interventions as a last resort, preferring to wait to see whether its competition/ market based interventions work. This can result in detriment and harm continuing while the FCA waits to see if its market experiments work.

It would be an aid to good policymaking and regulatory accountability if the FCA was required to publish a comparative impact assessment of:

i. 'doing nothing';
ii. its preferred intervention; and
iii. direct interventions such as price caps or product regulation.

Moreover, when the FCA's considers issues relating to Equality and Diversity the impact assessment it undertakes is very cursory – particularly with regard to the impact on people with protected

characteristics. These need to be more comprehensive. The Consumer Duty provides an ideal opportunity for the FCA to review the criteria it uses in equality impact assessments.

Q20: Do you have any other comments on the draft non-Handbook guidance?

The FCA in, 2A.1.6 G, states that: *'Firms should be aware that particular groups of retail customers, for example those who share age, race, socioeconomic background or characteristics of neurodiversity may have or be more likely to have "characteristics of vulnerability" as referred to in this chapter.'*

This is a welcome point to make. But, it would be more powerful if the guidance made it clear that firms should undertake monitoring and analysis to understand the impact of their business models and activities on these groups.

Of course, firms are restricted in their ability to gather information on an individual customer's ethnicity. However, it is possible to identify by proxy the impact of activities on different groups. The FCA's modelling, undertaken as part of its work on the overdraft market, was able to identify that BAME consumers were more likely to be adversely affected by very high charges.[15] Firms should be able, and therefore required, to undertake similar analysis to understand the impact of their activities on groups likely to have characteristics of vulnerability.

In 2A.2.20 G, the FCA states that: '*A firm will not be acting in good faith or reasonably where it seeks to exploit its interactions with retail customers and that exploitation is likely to lead to retail customer detriment….'.*

This is welcome but the FCA should make clear in the guidance that firms should take additional steps to ensure that the use of digital and data services (which are by definition designed to exploit consumer behavioural biases) do not result in consumer detriment. This is particularly important when it comes to consumers with characteristics of vulnerability.

We would also welcome further clarification in the guidance on what the FCA intends to be understood by the term *average consumer* (see 2A.5.2). What benchmark does the FCA suggest should be used to judge what constitutes the 'average' consumer?

Moreover, by definition, many consumers will have less understanding of financial matters than the 'average' consumer, others will have more understanding. The FCA should make it clear that testing the level of consumer understanding in the target market using the 'average' consumer as a benchmark would not be enough to comply with the expectations conveyed in this outcome.

[15] CP18/42: High-Cost Credit Review: Overdrafts consultation paper and policy statement (fca.org.uk), para 3.9

Q21: Can you suggest any other examples you consider would be useful to include in the draft non-Handbook guidance?

In addition to our suggestions on the existing draft guidance, see Q20., we would include under **2A.6 Consumer Duty: retail customer outcome on consumer support** guidance relating to dealing with county court judgments.

As we explained above, we are concerned that the proposals in CP21/36 do not place enough weight on the need for firms and others in the market to treat consumers fairly throughout the *whole* of the firm/ customer relationship especially when consumers might be in difficulty.

Therefore, as part of the guidance on Consumer Support, firms should be required to notify the courts in England and Wales (and to Registry Trust for other UK jurisdictions) when a debt has been settled.

Importantly, this failure to ensure CCJs are marked as satisfied could actually prevent other firms that wish to offer better value products to those consumers who have paid a CCJ. This not just has implications for access to fair and affordable products but can undermine effective competition. Therefore, the guidance should also require firms to ensure that they are not acting in a way that prevents consumers from exercising choice including moving to alternative provider firms.

This marks the end of FIC submission