

## United Kingdom: FCA publishes detailed Consumer Duty proposals

### In brief

On 7 December 2021, the FCA published its **second consultation** on the Consumer Duty, setting out more developed proposals for rules and guidance following feedback from its first consultation.

The proposals set out in the first consultation have been mostly carried forward, though the FCA has made some important amendments and clarifications in response to feedback received. For more detail on the first consultation, including background to the introduction of a Consumer Duty, please see our previous **alert**.

### The updated Consumer Duty package

The Consumer Duty remains a package of three elements:

- The **Consumer Principle**: A firm must act to deliver good outcomes for retail clients.
- The **Cross-cutting Rules**, which require firms to:
  - act in good faith towards retail customers;
  - avoid causing foreseeable harm to retail customers; and
  - enable and support retail customers to pursue their financial objectives.
- The **Four Outcomes** to be achieved by the Consumer Duty:
  - Products and services: consumers are sold products and services that have been designed to meet their needs, characteristics and objectives.
  - Price and value: consumers pay a price for products and services that represents fair value to them.
  - Consumer understanding: consumers are equipped with the right information to make effective, timely and properly informed decisions.
  - Consumer support: customers receive the support they need.

These elements have been reformulated from the proposals set out in the first consultation to better achieve the FCA's aims. The FCA has chosen Option 1 for the Consumer Principle: *A firm must act to deliver good outcomes for retail clients*. This wording also avoids much of the confusion with a fiduciary duty (as had arisen in response to proposed Option 2, *A firm must act in the best interests of retail clients*), or a policy that required the best outcome to be achieved for each consumer, as well as other existing "best interests" language in some parts of the Handbook.

The Cross-cutting Rules have been reworded to remove the reference to firms taking "all reasonable steps". The FCA wants firms to focus on acting reasonably, rather than focusing on processes and the steps they take, which could have the result of firms seeking to focus on compliance with the rules rather than ensuring good outcomes for their customers. Instead, the entire Consumer Duty is underpinned by a concept of reasonableness. The standard reflects the tortious concept of how a reasonable prudent firm would act and is one firms are already familiar with due to existing duties under common law - new proposed rules

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require firms to interpret the Consumer Principle in accordance with the standard that could reasonably be expected of a prudent firm:

- carrying on the same activity in relation to the same product; and
- making assumptions about the needs and characteristics of its retail customers based on the needs and characteristics of an average retail customer.

Proposed guidance also clarifies that the Consumer Duty does not create a fiduciary relationship where one does not otherwise exist, nor require advice to be provided where it would not have otherwise been required.

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## Key amendments and clarifications

The FCA has amended and clarified a number of their proposals from the first consultation. We've set out below a number of key points in the proposals.

### Scope

The FCA has recognised that applying a single standard definition of "retail customer" to the Consumer Duty could create challenges in different sectors, and would be disproportionate. Therefore, for the purposes of applying the Consumer Duty, the FCA is proposing to align the scope of "retail customer" with the existing definitions of retail customer of the sectoral sourcebooks. For example:

- For consumer credit, the Consumer Duty will apply to all regulated credit-related activities.
- For deposit-taking activities, the Consumer Duty will apply to consumers, micro-enterprises and charities with a turnover of less than £1 million (in line with the banking customer test).
- For insurance, the scope follows the position in the Insurance Conduct of Business Sourcebook (ICOBS). The Consumer Duty does not apply to reinsurance or contracts of large risk sold to commercial customers.
- For investments, the Consumer Duty applies to business conducted with retail clients, as defined in the Conduct of Business Sourcebook (COBS).
- For mortgages, the Consumer Duty follows the position in the Mortgage Conduct Business Sourcebook (MCOB). The Consumer Duty therefore applies to all regulated mortgage contracts within the perimeter, but not, for example, unregulated buy-to-let contracts or commercial lending. Where the owner of a mortgage book is unregulated and the regulated party is an administrator, the Consumer Duty would apply in an appropriate and proportionate manner to their function.
- For payment services, in line with the Payment Services Regulations 2017, the Consumer Duty applies to business conducted with consumers, micro-enterprises and charities.

### Interaction with other Principles and rules

Given the overlap between the new, higher standard set by the Consumer Duty and Principles 6 and 7, the FCA proposes to disapply both Principles 6 and 7 where the Consumer Duty applies. Principles 6 and 7 will therefore continue to apply to conduct outside the scope of the Consumer Duty, for example certain SMEs and wholesale business.

The FCA has also explained how the requirements under the Consumer Duty will interact with the existing product governance and fair value rules in the Product Intervention and Product Governance Sourcebook (PROD) for financial instruments (PROD 3), insurance (PROD 4) and funeral plans (PROD 7). If a firm's product or service is subject to those rules, it must continue to comply with those rules. If a firm's product or service would have been subject to the rules in PROD for:

- financial instruments (PROD 3) if it had been created or significantly adapted on or after 3 January 2018; or
- insurance (PROD 4) if it had been created or significantly adapted on or after 1 October 2018 and it is not a legacy non-investment insurance product,

the firm may elect to comply with those rules or to comply with the Consumer Duty's products and services outcome. Where firms comply with these PROD requirements, including where they elect to do so (as set out above), this will tend to establish compliance with their obligations under the products and services outcome. However, the obligations under the Consumer Duty as a whole are



broader than the requirements under PROD, and as a consequence the FCA warns that satisfying the existing rules in PROD is unlikely to mean a firm meets all aspects of the Consumer Duty.

## Application outside the UK

The FCA proposes to require UK distributors of non-UK products and services (to UK retail customers) to take all reasonable steps to comply with the products and services outcome – e.g., to understand the product or service and the target market it would serve in order to ensure it will be distributed appropriately. This is in line with the general requirement for distributors to take all reasonable steps to comply with the obligations under the products and services outcome when selling a product or service that was manufactured by a person not subject to the Consumer Duty.

The FCA also proposes to apply the Consumer Duty to firms in the temporary permissions regime (TPR), 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 - and this will include firms in supervised run-off under the financial services existing contracts regime.

Where firms are dealing with non-UK customers, the Consumer Duty will apply in the same way as existing sectoral sourcebooks.

## Fair value

The FCA has confirmed that, to achieve the "fair value" outcome, firms do not need to charge the same price to all consumers, and in certain circumstances differential pricing will be appropriate. Further, value must be considered in the round and low prices do not always mean fair value. Firms which do not interact directly with customers, including those in the e-money and payment sector, need to consider their role in the value chain.

## Private right of action

Importantly, the FCA does NOT propose to introduce a private right of action in relation to the Consumer Duty at this time. However, the FCA will keep the possibility of a private right of action under review, including in light of how firms embed and comply with the Consumer Duty.

## Monitoring outcomes

This second consultation also proposes guidance from the FCA on how firms should monitor consumer outcomes, including governance arrangements and the types of data and information that firms could use – interestingly, the FCA includes "allowing staff to feedback honestly" as an example of information which may help firms to identify whether they are delivering good outcomes, reflecting the FCA's focus on embedding good culture by fostering an environment where staff feel able to raise or express concerns.

The second consultation also explains how the FCA will embed its regulatory approach to the Consumer Duty in the Authorisations, Supervision and Enforcement divisions – a warning to firms who may seek to become authorised in the future

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## New senior management proposals

The FCA has also introduced proposals to amend the Senior Managers and Certification Regime individual conduct rules 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. The effect of this is that the proposed new rule would apply to conduct insofar as it relates to retail activity and Rule 4 would be limited in application to conduct related to non-retail activity, mirroring the approach the FCA is proposing to take for the Principles where the new Consumer Duty will apply to firms' retail activity and Principles 6 and 7 would continue to apply to non-retail activity.

The FCA is also proposing to include obligations as part of this new individual conduct rule that reflect the Consumer Duty's Cross-cutting Rules. 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.



The obligations under the new individual conduct rule would apply to the extent that is reasonable and proportionate, meaning the particularities of a person's job and their seniority may affect the scope of their duty under the new rule. The FCA confirms that the Consumer Duty does not require a single senior manager to be responsible for compliance with all aspects of the Consumer Duty – instead, all senior managers are responsible for ensuring that the business of the firm complies with the requirements of the Consumer Duty on an ongoing basis.

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## Next steps and implementation

The second consultation closes on 15 February 2022. A policy statement and final rules are expected by 31 July 2022.

The FCA proposes that firms will have until 30 April 2023 to fully implement the rules. However, the FCA is keen to hear views on this timetable now that the full set of rules have been proposed, so there may be further refinement of this implementation period. Notably, the FCA expects firms to use the implementation period fully and to be able to demonstrate progress when asked, and the FCA will carry out work during the implementation period to monitor firms and assist.

The period proposed by the FCA between final rules and implementation – nine months – does not leave firms with a great deal of time to prepare and implement necessary changes. Firms will need to ensure that they grasp and understand the Consumer Duty; perform gap analysis on their policies and processes; make relevant adjustments through change projects on product and service design, price and value, customer support and so on; train their staff on the new requirements; design and implement any required IT system changes; and establish processes to monitor and test consumer outcomes.

Additionally, during this time period, firms are expected to review their products and services, and if needed 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.

While the Consumer Duty will not apply retrospectively to past business, the Consumer Duty will apply to closed products or services on a forward-looking basis. The FCA does not expect firms to apply rules that are not relevant (such as identifying a target market), but firms will be expected to identify whether there are aspects of the design of the product or service which mean they are not meeting the rules, and take appropriate action to mitigate harm. This may involve, for example, providing greater customer flexibility for switching to products which are unencumbered by the identified issues. However, the FCA makes it clear that it does not expect firms to give up any contractual rights they had a "firm" expectation of being able to enjoy (including vested remuneration rights) in taking action to mitigate harm.

Firms which are part of distribution chains will also need to carefully review the Consumer Duty requirements and, in some cases, make complex and costly changes to their arrangements and associated documentation. In general, firms would be responsible only for their own activities and would not need to oversee the actions of other firms in the distribution chain - the FCA is not proposing to make all firms in the distribution chain responsible for consumer outcomes on a joint and several basis, and firms would not be able to transfer their responsibilities to other firms. However, where firms work together to manufacture a product or service, the FCA proposes that they must have a written agreement appropriately setting out their mutual responsibilities, which clarifies the extent to which firms in the distribution chain are responsible for meeting different requirements and, therefore, the extent to which they are liable. Further, principal firms in appointed representative (AR) arrangements will need to consider both the proposed Consumer Duty requirements as well as the stronger oversight requirements proposed recently by the FCA (see our related alert [here](#)).



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