

United Kingdom: FCA proposes stronger protection for consumers in financial markets

In brief

Continuing its increasing focus on fair customer treatment and achieving good customer outcomes, the UK Financial Conduct Authority (FCA) has published a [consultation](#) on a new Consumer Duty, which would set higher expectations for the standard of care that firms provide to consumers. The Consumer Duty would require firms to:

- ask themselves what outcomes consumers should be able to expect from their products and services;
- act to enable rather than hinder these outcomes; and
- assess the effectiveness of their actions.

The Consumer Duty is proposed as a package of measures: a new **Consumer Principle** that provides an overarching standard of conduct, supported by a set of **Cross-cutting Rules** and **Four Outcomes** that set clear expectations for firms' cultures and behaviours. The FCA's aim is to give firms more certainty about the standards expected of them and, correspondingly, the standards that consumers can expect of firms. Under the proposed Consumer Duty, firms would need to ensure that their products and services are fit for purpose and offer fair value, and that their communications and customer service enable consumers to make and act on well-informed decisions.

The FCA's focus on preventing customer harm has come into sharp relief in light of the effects of the COVID-19 pandemic, with broad thematic work taking place across the investments, insurance, mortgages and credit markets to ensure fair pricing and fair treatment of customers. The Consumer Duty proposals follow on from a number of recent pieces of work in this area, including among others finalised [guidance](#) on the fair treatment of vulnerable customers, a [discussion paper](#) on strengthening financial promotion rules, and [work](#) on fair pricing in financial services. The proposals are also part of the FCA's revised approach to regulation, underpinned by its internal transformation programme, which aims to clarify the regulatory outcomes that the FCA should achieve and ensure that the FCA has the internal capabilities to support delivering those outcomes.

In this alert we explore the FCA's proposals, and what they mean for firms and senior management.

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Scope

The Consumer Duty proposals apply to firms in relation to their regulated activities, and relate to products and services sold to 'retail clients' - all clients other than professional clients and eligible counterparties. This means that, in addition to individuals, in most cases, where the FCA regulates the provision of financial services to SMEs, these proposals would apply. The Consumer Duty would also apply to electronic money institutions, payment institutions and registered account information service providers.

The proposals extend to firms that are involved in the manufacture or supply of products and services to retail clients, even if they do not have a direct relationship with the end customer. The Consumer Duty would apply where a firm can, through its regulated activities, influence material aspects of the design, target market or performance of a product or service that will be used by consumers. This means 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. However, what the Consumer Duty will require from those firms will be dependent on their ability to influence outcomes for consumers. The FCA proposes to embed a concept of



reasonableness in the Consumer Duty, to be read alongside how the Consumer Duty's requirements are to be interpreted – for more about this, see further below.

The Consumer Duty

The Consumer Duty is a body of rules, set out as a package of three key elements:



Sets a clear tone and uses language that reflects the overall standards of behaviour expected from firms



Develop and clarify the Consumer Principle's overarching expectations of firm conduct, and set out how it should apply in practice



Set more detailed expectations for firm conduct in relation to four specific outcomes for the key elements of the firm-customer relationship

The Consumer Principle

The Consumer Principle is intended to set a higher standard than the existing requirement of Principle 6 of the FCA's Principles for Businesses (PRIN) for a firm to "pay due regard to the interests of its customers and treat them fairly". It would be an objective standard that would require firms to consider the reasonable expectations of their customer base as a whole, rather than achieving the absolute best outcome for each and every customer.

The FCA is considering two options on the wording of the Consumer Principle:

- **Option 1: A firm must act to deliver good outcomes for retail clients.** This wording places emphasis on consumer outcomes, and firms' obligation to be proactive in delivering those outcomes. The concept of a 'good outcome' does not have an established legal meaning. The rules and guidance in the wider Consumer Duty would give firms greater clarity on what 'good' looks like.
- **Option 2: A firm must act in the best interests of retail clients.** The reference to "best interests" conveys how the FCA wants firms to challenge themselves to do the right thing for consumers. A duty based on the best interests of customers already exists in a number of Handbook rules – for example, firms in the insurance, investments and mortgages sectors are already under a similar obligation. By using this language in the Consumer Principle the FCA would extend this expectation, giving it greater prominence in the Handbook, and bringing greater consistency to its expectations for the conduct of firms in retail markets. **However, it is not the FCA's intention that this wording would give rise to a fiduciary relationship.**

Regardless of formulation, the Consumer Principle should prompt firms to ask themselves questions such as "Am I treating my customers as I would expect to be treated?" or "Are my customers getting the outcomes from my products and services that I would expect?"

The FCA is likely to place the Consumer Principle alongside the existing 11 Principles in PRIN. Interestingly, the FCA considers that conduct meeting the requirements of the Consumer Duty would generally meet regulatory expectations under Principles 6 and 7 as well, and it is likely that in future the FCA would make use of the Consumer Duty, and its more developed rules, in preference to the existing Principles 6 and 7. However, the FCA expects to retain Principles 6 and 7 at least in the short term, and is still considering whether to disapply them where the Consumer Duty applies.

The Cross-cutting Rules

The proposed Cross-cutting Rules would develop the standards of conduct expected under the Consumer Principle. These rules would require three key behaviours from firms – firms must:

- **Take all reasonable steps to avoid foreseeable harm to consumers.** Firms should not cause harm to customers through their conduct, products or services and should take proactive steps to avoid it, where they can. Firms should not seek to exploit customers' vulnerabilities, behavioural biases or lack of knowledge. They should be fair in describing the benefits and



risks of products and services, not disguise these through misleading framing, omission, or burying key terms in documents they know customers will not read.

- **Take all reasonable steps to enable consumers to pursue their financial objectives.** Firms will be expected to take responsibility for establishing an environment in which consumers can act in their own interests. Firms should take reasonable steps to understand behavioural biases and vulnerability characteristics, and use their knowledge of how consumers behave to enable and support them to make good decisions.
- **Act in good faith.** Firms should exhibit a standard of conduct characterised by honesty, fair and open dealing and consistency with the reasonable expectations of consumers. This standard of conduct aims to address the imbalance in bargaining position, knowledge and expertise between firms and consumers.

The Four Outcomes

The Four Outcomes represent the key elements of the relationship between firm and customer, including design, sale and service of products and services, and the key contact points along the customer journey. The FCA proposes to set expectations for the Four Outcomes in a suite of rules and guidance building on the Consumer Principle and Cross-cutting Rules. These outcomes are:

- **Communications: communications equip consumers to make effective, timely and properly informed decisions about financial products and services.** This outcome will reinforce and build on the concepts in the first part of Principle 7 ("pay due regard to the information needs of its clients") by requiring firms to focus much more on consumer outcomes. The FCA proposes to introduce rules that require firms to communicate in a way that, in addition to being fair, clear and not misleading, is understandable and facilitates informed consumer decisions. The FCA also proposes to require more of firms in testing that their communications are understandable, and adapting them where necessary to ensure they are supporting this outcome. However, these proposals would not require firms to verify that all individual customers have in fact understood the information provided. Rather, firms would be required to take appropriate steps to satisfy themselves that their communications are reasonably likely to be understood by their recipients. These requirements would apply to all firms involved in the production of consumer communications, regardless of whether the firm itself has direct consumer relationships, for example when approving financial promotions on behalf of others.
- **Products and Services: products and services are specifically designed to meet the needs of consumers, and sold to those whose needs they meet.** The FCA intends to build on the Product Intervention and Product Governance Sourcebook (PROD) requirements to address the harm it sees in relation to the design and distribution of products and services by introducing cross-sectoral requirements reflecting the key obligations in PROD, positioned under the Consumer Duty (but not replacing PROD itself). This should mean products and services sold to consumers have been designed to benefit them and perform as would reasonably be expected. These rules would apply from design and manufacturing to distribution and monitoring after sale; however, the requirements would apply only to all product and service lines available for distribution to consumers after the Consumer Duty comes into effect, and firms would not be expected to apply them to past sales.
- **Customer Service: customer service meets the needs of consumers, enabling them to realise the benefits of products and services and act in their interests without undue hindrance.** The FCA is proposing to set requirements for firms' customer service arrangements to be of a standard that meets consumers' reasonable needs and expectations. The rules and guidance to implement this outcome would require that customer service arrangements do not unduly hinder consumers from realising the benefits of products/services, or acting in their own interests, and do not lead consumers to incur unreasonable additional costs (whether time, money, inconvenience, data, and so on). For example, it should be at least as easy to exit a product or service as it is to purchase it in the first place.
- **Price and Value: the price of products and services represents fair value for consumers.** The FCA intends to set out a clear and consistent expectation of how firms should assess whether the price of products and services offers fair value. Firms should be able to demonstrate that the benefits of their products and services are reasonable relative to their price (including all costs and charges, which may not be financial). Firms would be expected to demonstrate that they have made a value assessment and consider the relationship between price and benefits is reasonable, and senior management would be held accountable for the assessment. However, the FCA is not proposing to set the levels at which firms should price their products or services, nor to use the proposed rule itself to introduce market interventions, such as price caps or other price interventions.



Reasonableness

The FCA proposes to embed a concept of reasonableness in the Consumer Duty. Reasonableness is intended to clarify the objective standard of conduct that firms need to meet, and will apply to the interpretation of all of elements of the Consumer Duty, from the high level Consumer Principle and Cross-cutting Rules to the detailed rules and guidance underpinning Four Outcomes. The FCA intends to set out factors that influence what is reasonable - these are factors that have a significant impact on what the Consumer Duty means in practice for firms' conduct, and include:

- The nature of the product or service being offered or provided (including the nature of the firm's role and relationship with consumers, the potential of the product or service to harm consumers, and the complexity of the product or service). This may mean taking additional care where a product or service is higher risk, or taking more onerous steps at points where the consumer is making decisions which carry a higher risk of adverse outcomes.
- The role of the firm in the distribution chain. As explained above, what the Consumer Duty will require from firms will be dependent on their ability to influence outcomes for consumers.
- The reasonable expectations of consumers. Reasonable consumer expectations will vary depending on the nature of the product or service – for example, what consumers may reasonably expect from a premier service will differ from expectations regarding a service marketed as basic.
- The specific characteristics of customers, including characteristics of vulnerability. This means that firms will need to recognise and respond to the different needs of different consumers, particularly those needs relating to vulnerability, and may need to take action when distinct groups of consumers receive systematically poorer outcomes.

Alignment with vulnerability, equality and diversity concerns

The FCA highlights in the consultation that firms should take additional care to ensure vulnerable consumers receive outcomes that are as good as those for other consumers. This aligns with the regulator's recently published [guidance](#) on the fair treatment of vulnerable consumers. The Consumer Duty proposals make explicit reference to the need for firms to provide an additional level of care to ensure they meet the needs of customers who are vulnerable. This means that the FCA Handbook will make express provision about the treatment of vulnerable consumers, when those rules are proposed in the second consultation.

As noted above, the FCA would expect firms to investigate the causes giving rise to distinct groups of customers experiencing different outcomes from a firm's products or services. Firms would need to satisfy themselves, and be able to evidence to the FCA, that any different outcomes are compatible with the standards required by the Consumer Duty for all customers. This is especially important where groups sharing protected characteristics (as defined in the Equality Act 2010) may be disadvantaged - the FCA would view a firm that unlawfully discriminates between customers in breach of the Equality Act 2010 as likely to be in breach of the Consumer Duty.

Private right of action

The FCA is not making any specific proposals on a private right of action at this stage, but has set out the arguments that have been made for (e.g. deterrent effect, availability of industry-wide redress schemes) and against (e.g. risk-aversion, chilling effect on innovation, possible increased costs for firms and consumers).

What this means for firms and senior managers

This is a first-stage consultation and does not contain draft Handbook text. The consultation closes on 31 July 2021. The FCA expects to publish the second consultation setting out proposed rules and guidance by 31 December 2021, and will make any new rules by 31 July 2022.

The FCA hopes that the implementation of the Consumer Duty will create a paradigm shift in its expectations of firms in retail markets. While some firms may already be operating in line with these expectations, others would need to adapt significantly to meet them. The effect of these proposals is that firms will need to have a stronger focus on customers' interests and outcomes, going beyond a narrow focus on compliance with the rules. Firms will need to consider the Consumer Duty at every stage of their



processes and at every level of the organisational structure. Senior management should expect to be held accountable, and there should be clear lines of responsibility for implementation.

It is clear that the FCA intends for firms to embed good customer outcomes in the design and manufacture stage. When designing products or services, firms will need to place greater emphasis on putting customers in a position where they can make decisions to meet their needs (such as protecting against a risk) or pursue their financial objectives (such as planning for retirement). The aim is that firms would "get it right in the first place", a clear expectation from the FCA that firms should anticipate, and incorporate, customer perspectives when designing products.

Firms should also expect to turn their focus to their internal processes and actions. The FCA expects the proposals to provide clarity on where responsibilities lie, and an understanding of the outcomes expected. This will mean, therefore, that firms will need to exercise more judgment in determining how their behaviours, policies and processes contributing to achieving those outcomes.

Firms should expect to engage in regular monitoring and testing exercises on an ongoing basis to ensure outcomes are delivered, and to evidence that monitoring and testing to the FCA. This will also mean adapting firm practices and processes, where necessary.

The Consumer Duty proposals are a continuation of the FCA's increasing focus on customer outcomes. Treatment of customers, especially vulnerable customers, is clearly a long term cultural focus for the FCA, and more clarity will be provided to firms as the Consumer Duty develops and future "Principles-based" methods of governance. Regulatory expectations in this area are likely to be fast-paced in the current climate, where high standards of firm culture and integrity are seen as business-as-usual. Firms should ensure that they pay due regard to the FCA's views on customer treatment, especially in the context of the pandemic.



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