FCA Consultation on new Consumer Duty due to close on 15 February 2022

After the FCA published more developed proposals on the FCA's new Consumer Duty in December 2021, there is a final opportunity to comment on the practical implications of the proposed changes before the FCA publishes the final rules this summer

The proposed new "Consumer Duty" involves a package of measures promoting an 'outcomes based' culture in relation to all dealings with existing and prospective customers across UK regulated firms (and EEA firms under the temporary permissions regime whether from a UK establishment or on a cross-border services basis).

The insurance industry will recall the period when the concept of 'Treating Customers Fairly' was embedded. Now, in anticipation of the final FCA rules and guidance being published at the end of July 2022, businesses will need to ensure that they are appropriately resourced so that by the end of April 2023 their products, services and processes adhere to the new rules and guidance.

The FCA considered comments from the first consultation process, which took place last summer, and on 7 December 2021 published CP21/36. This provided feedback on the over 200 responses to CP21/13, attached a set of draft rules and guidance and raised various questions for the second consultation process that closes on 15 February 2022.

One key point is that the FCA is not proposing to take steps to introduce a Private Right of Action at this point, but will keep this under review – a decision welcomed by the Association of British Insurers.

Package of measures

The new Consumer Duty is a package of measures with three elements: (i) a Consumer Principle (new Principle 12), (ii) what are described as 'cross-cutting rules' to develop and clarify this, and (iii) 'four outcomes', which are broadly that products and services are:

- fit for purpose for their consumers
- fair value
- understood by consumers so that they can make informed decisions, and
- provide support to meet consumer needs.

The new Consumer Duty applies to regulated business. Although it does not apply to unregulated business, it shall apply to authorised firms conducting 'ancillary activities'.

Standard of care

The proposed new Consumer Principle that *"a firm must act to deliver good outcomes for retail clients"* shall set a higher expectation for the standard of care that firms provide to consumers.

As the FCA explained when introducing CP21/13 in May 2021, this *"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 Consumer Duty requires only what is reasonable to expect of firms, in other words, the standard that could reasonably be expected of a prudent firm carrying on the same activity in relation to the same product, with the necessary understanding of the needs and characteristics of customers that are based on the average customer (3.11 of draft Guidance – Appendix 2 of CP21/36).

It is not intended that the new Consumer Duty would require a firm to assume a 'fiduciary duty' or require an advisory service (where it does not already exist).

Key behaviours

The key behaviours are to:

- act in good faith
- avoid foreseeable harm to consumers
- enable and support consumers to pursue their financial objectives.

With increased understanding of behavioural science, the FCA wants firms to focus on consumer outcomes.

However, the new Consumer Duty does not remove customers' responsibility for their own choices and decisions.

FCA's role

The Financial Services Act 2021 required the FCA to consider and consult on the level of care regulated firms provide to consumers. These consultation processes enable the FCA to meet this requirement.

Resourcing these changes

Firms will be expected to satisfy themselves (including at least annually at Board level) and be able to demonstrate to the FCA through a process of monitoring, testing and, where necessary, making adaptions, that they comply with the requirements of the proposed new Consumer Duty.

This will involve ensuring that relevant data is being collected, and is analysed against the expected outcomes on a sufficiently regular basis. Firms will need to assess this information and be able to show evidence (if requested by the FCA) of the extent to which, and how, the firm is acting to deliver good outcomes for customers.

Accountability of senior managers

The FCA has explained that it shall be holding senior managers accountable if, in effect, they do not put consumers at the heart of what firms do. This does not mean that one senior person for each firm will ultimately be responsible for compliance with all aspects of the Consumer Duty. Rather, it is intended that all senior managers must each take responsibility for the role they play in delivering compliance on an ongoing basis (9.28-29 of draft Guidance – Appendix 2 of CP21/36).

The FCA is proposing to amend their Senior Managers and Certification Regime rules to ensure there is clear accountability within firms for compliance with the Consumer Duty.

No direct relationship with end customer required

The FCA's proposals apply to firms in respect of their regulated activities and extend to firms involved in the manufacture or supply of products and services to retail customers (consumers), even if they do not have a direct relationship with the end customer.

Distributors

The draft Guidance indicates that the general position is firms are responsible for their own activities (2.15 of draft Guidance – Appendix 2 of CP21/36). However, where firms outsource activities to third parties, they remain responsible for compliance.

Sometimes there are several firms in a distribution chain. When considering a chain of distributors, what is reasonable to expect of each firm will depend on their respective roles and their ability to influence customer outcomes.

The draft Guidance emphasises that distributors must understand the products or services they distribute and not distribute if they do not understand them sufficiently (5.31-32 of draft Guidance - Appendix 2 of CP21/36). Therefore, distributors must ensure that they get appropriate information from the manufacturers (usually the insurer in this context) so that they have sufficient understanding.

This also highlights a cross-industry objective to continue to promote education. It is therefore helpful that one of the consequences of the COVID-19 pandemic has been an increase in delivery of education via webinars on a 'live' basis or at a time that suits the attendee.

Ancillary activities

The new Consumer Duty does not apply to unregulated business, but shall apply to authorised firms conducting ancillary activities. Paragraph 2.36 of the draft Guidance at Appendix 2 of C21/36 states that 'ancillary activities' are *"unregulated activities in connection with, or for the purposes of,*

regulated activities, including, where relevant, regulated activities carried on by a different firm in the distribution chain".

Co-manufacturers of a product/service

Sometimes an insurance contract is branded by a broker, with the risk being underwritten by the insurer. The broker together with the insurer should have a particular target market in mind, and where the broker would have some influence over features of the product (in other words a 'decision-making' role) they could each be regarded as 'co-manufacturers'. It is therefore important that where this collaboration occurs they have a written agreement outlining their respective roles and responsibilities to comply with the rules relating to the proposed new Consumer Duty.

Vulnerable customers within target market

In February 2021, the FCA launched its guidance for firms on the fair treatment of customers in vulnerable circumstances (FG21/1). When considering this in the context of the new Consumer Duty, the draft Guidance gives the example of holding focus groups with customers in vulnerable circumstances or communicating with consumer representatives when developing a new product or service, to enable the needs to be identified, as well as contacting specialist organisations for information.

Not retrospective

The Consumer Duty would not apply retrospectively to past business (in other words, past actions by firms). However, it would apply on a 'forward-looking' basis to existing products or services i.e those that are either still being sold/renewed or are 'closed' products/services.

For example, with existing products/services, the insurance contract terms and conditions may need to be reviewed (as this should be done on a regular basis) and, if appropriate, updated before the implementation deadline of 30 April 2023, before it can be sold to new customers. While the FCA guidance acknowledges that firms would not be expected to give up contractual rights they had a firm expectation of being able to have, matters such as whether there is a breach of the Consumer Rights Act 2015 should be considered as part of that review.

Testing and monitoring of products/services by firms

The draft Guidance refers to carrying out testing of how the product or service is likely to function; this would involve taking into account how to guard against any previous problems identified in the product/service, as well as considering what might happen in the future.

An insurance company would, for instance, be aware what issues had arisen in complaints and if those complaints had not been resolved internally, what issues had then been referred to the Financial Ombudsman Service and their outcome.

Customer experiences could be tested through, for example, focus groups, customer feedback/surveys and even giving staff the opportunity to give feedback.

Significantly, the FCA recognises that a firm's approach to testing will reflect their capabilities and resources. However, it has stated that it would *"expect all firms to be able to demonstrate that they have a proportionate approach that provides them with confidence that consumers can understand their communications."*

By monitoring appropriate Management Information on the impact of communications, the aim would be to identify areas that warrant further investigation by the firm, as part of a root cause analysis. The FCA acknowledges that the MI should be *"appropriate to the nature, scale and complexity of their business, considering the size of the firm, the products and services they offer, and the consumer base they serve"*.

These testing and monitoring tasks would need to be appropriately resourced and the Board (or equivalent governing body) updated at least annually in relation to the firm's assessment of whether it is delivering good outcomes for its' customers which are consistent with the Consumer Duty. Any action points should also be agreed at least annually by the Board (or governing body).

Impact on Principle 6 (due regard & TCF) and 7 (information & communication)

Where Principle 12 applies existing Principles 6 and 7 shall not, but the existing guidance on Principles 6 and 7 have still been described by the FCA as remaining 'relevant' to firms, when considering their obligations under the Consumer Duty (1.16 of draft Guidance – Appendix 2 of CP21/36).

Failure to act in accordance with existing guidance on Principles 6 and 7 is described by the FCA as 'likely' to breach the Consumer Duty in Principle 12, which imposes a 'higher and more exacting' standard of conduct on firms than Principles 6 and 7.

The Debate regarding a possible Private Right of Action

There has been much debate by interested parties on the pros and cons of whether to introduce a Private Right of Action.

When the FCA published its latest consultation paper (CP21/36) on the proposed new Consumer Duty in early December 2021, the ABI announced that:

> *"we're pleased to see the FCA is not proposing to introduce the Private Right of Action at this time as it would have added complexity for consumers, without benefits above the current redress process. Much work has already been done in this highly-regulated area of consumer protection and, as the FCA acknowledges, there is good practice by firms to innovate to meet the needs of customers".*

In terms of current options potentially available to consumers, depending upon the facts, Section 138D of the Financial Services and Markets Act 2000 (FSMA) allows individuals a right of Court action for compensation for loss caused by a breach of FCA rules (subject to limited exceptions). While this applies to most of the FCA's rules, it does not apply to breaches of the FCA's Principles. Sometimes claimants elect to add a Section 138D claim to their Court claim. However, a firm's internal complaint process and the continued availability of the Financial Ombudsman Service dispute resolution scheme should present a practical solution for the majority of consumer complaints.

CPB Comment

The FCA wants firms to put themselves in the shoes of existing and prospective customers and to review thoroughly whether customer-focused outcomes are being achieved and what adaptions to make to support and empower customers to make good financial decisions and avoid foreseeable harm.

As with the introduction of the TCF principle, the viewpoint to be taken into account is an objective one.

These proposed new regulatory measures relate to very wide-ranging circumstances (insurance, pensions, credit, investments and so on), and represent a notable change to the regulatory approach, which will need to be properly resourced and planned for within regulated firms.

In the advent of the FCA using its Test Case powers in response to non-damage Business Interruption claims relating to the pandemic, we are again seeing a more assertive regulatory approach by the FCA. The FCA readily acknowledges this stating, *"the Consumer Duty aligns with our own transformation and our focus on being more assertive, innovative, and adaptable in our regulatory approach"* (paragraph 1.15 of CP21/36).

Where the FCA identifies practices that detrimentally affect customer outcomes, we can anticipate that it shall be more likely to intervene before those practices become entrenched as market norms.

We can also anticipate a greater emphasis on ensuring the quality of Management Information and documenting the assessment of relevant information, testing and monitoring processes in order to 'take stock' at least annually at senior level.

When considering new insurance product projects, timescales will need to factor in sufficient time to consider, appropriately test and to document what has happened, in the context of the target market for that intended product.

Each insurer (manufacturer) shall have its own insurance contract terms and conditions, which need to be reviewed in the light of the new Consumer Duty, but depending upon the particular insurance product there could be higher-level common themes/concepts that could, potentially, be explored on a wider industry group basis.

As the objective of these new regulatory changes is to stimulate innovation and competition (and not to see withdrawal of firms from the market due to the additional resourcing and costs involved), the questions are to what extent could that information gathering/testing be pooled amongst insurers (or insurance industry groups) and, secondly, to what extent would it be reasonable and proportionate for such steps to be carried out by each individual insurer?

In the context of income protection insurance, the former ABI Statement of Best Practice (SoBP) was a useful explanatory document for insurance legal advisers to send to claimants when there appeared to be misconceptions as to how the insurance cover would operate, and earlier access to this type of document could help avoid misconceptions arising in the first place. Re-igniting a

standard explanatory reference document for income protection (whether through the ABI or another platform) could be one method of promoting better understanding by prospective and existing customers (and new financial advisers entering the market) of common aspects of income protection. While the ABI has continued to update their SoBP for Critical Illness – re-branding it as a Guide to Minimum Standards of Critical Illness Cover, there is a case for bringing back standard guidance for income protection, as part of the drive to reduce the 'protection gap' in the UK and engage with prospective customers.

February 2022

Any questions

If you have any questions regarding the insurance-related issues highlighted in this article, please get in touch with Helen.

You can also review a range of articles on similar insurance and reinsurance topics in the Publications section of our website.

Helen Tilley
Partner

T: 0203 697 1910
M: 0750 182 5588
helen.tilley@cpblaw.com
LinkedIn