nucleus

Consumer Duty

A guide

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Introduction

It feels like we've been discussing Consumer Duty for a lifetime, with everyone on tenter-hooks for the final policy statement. It's finally here and we can't escape it (nor should we want to!).

The countdown clock is ticking and although the FCA has extended the final implementation date to July 2023, they're expecting quick action from senior managers in firms:

31 October 2022

A firm's board (or equivalent) must have agreed and signed off on Consumer Duty implementation plans

31 July 2023

Final Consumer Duty date implementation date for all firms

31 July 2024

Final implementation date for closed book policies

We're here to help you understand exactly what you need to do to prepare for it.

Consumer Duty isn't a binary set of rules, which means many firms are finding it hard to digest. On the back of MiFID II, GDPR, SM&CR and various other acronyms we're sure you're familiar with, we all knew exactly where we stood and what would be deemed 'falling short of the rules'.

But this is different. This is a whole new Principle implemented by the FCA.

Consumer Duty empowers regulated firms to make the exact decisions, but mandates that those decisions are based around positive customer outcomes, and consistently putting the client at the centre of the decision-making process.

As we all enter this new world, we're here to support you with everything you need - let this guide be your roadmap.

To start, we're going to look at how we got here, where we are now and where we need to be by the implementation date.

Paul Bagley

Distribution Director

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Route to Consumer Duty

Since Consumer Duty was first launched as a Consultation Paper in May 2021, the discussion has been loud, and further fuelled by the second Consultation Paper in December 2021.

The profession asked for further clarity, and for extensions to the initially proposed April 2023 implementation date. Now the final guidance is here, along with confirmation of that extended implementation date.

Straight away we were hearing Consumer Duty branded as ‘TCF on steroids’ and that ‘most firms are already doing it anyway’. These noises almost got so loud that the original purpose of Consumer Duty was lost.

Let’s cut through all of the noise and speculation, take it back to basics and start by asking ‘What is Consumer Duty?’

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Product Governance

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Individual Accountability (SMCR)

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Consumer Duty

Consumer Duty is a culture and behaviour shift. It's not the rigid set of rules that we may be used to, though this doesn't mean there's no expectation for firms to react - just that the outcome is slightly different to what the industry usually expects.

The whole concept of Consumer Duty is to recalibrate all regulated firms' focus to ensure that the customers' best interests are at the centre of every decision they make. Firms are being asked to stop having their business interests as their priority, and to put "themselves in the customer's shoes".

But why? In their supervision work, the FCA has highlighted, and continues to highlight, areas of poor practice where there's potential for customer detriment. The particular practices observed are:

- firms providing information that's misleadingly presented or difficult for consumers to understand, hindering their ability to properly assess the product/service
- products and services that aren't fit for purpose in delivering the benefits that consumers reasonably expect, or aren't appropriate for the consumers they're being targeted at and sold to
- products and services that don't represent fair value, where the benefits consumers receive aren't reasonable relative to the price they pay
- poor customer service that hinders consumers from taking timely action to manage their financial affairs and making use of products and services, or increases their costs in doing so
- other practices that hinder consumers' ability to act, or that exploit information asymmetries, consumer inertia, behavioural biases or vulnerabilities.

Where these occur, consumers suffer harm. They may:

- find it harder to make an informed or timely decision
- buy products and services that are inappropriate for their needs, of inadequate quality, too risky or otherwise harmful
- incur greater monetary and non-monetary costs
- receive sub-standard treatment during their relationship with a firm
- find it harder to switch or get a better deal.

In summary, misleading information, unsuitable products, incorrect or unfair pricing models, poor customer service and limited consideration of the impact of a service on customers, including those with characteristics of vulnerability.

That's quite a lot. And all of the above leads to poor outcomes for the end customer, so no wonder they've been highlighted. These are some of the key problems the FCA feels are inhibiting the industry from delivering the best service to customers Their solution? Consumer Duty.

The FCA is implementing a new Consumer Principle (Number 12), which has overarching cross-cutting rules, focusing on four outcomes. We'll break these down and explain exactly what the regulator means, then continue to discuss how firms can apply this.

We've also built a useful checklist available for advisers. Visit our Consumer Duty hub to find out more.

A firm must act to deliver good outcomes for retail customers

Consumer Principle

Firms must act in good faith

Firms must enable and support retail customers to pursue their financial objectives

Avoid causing foreseeable harm

Cross-cutting rules

Design of products and services

Price and value

Consumer support

Consumer understanding

Four outcomes

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Breaking down the jargon

The FCA's Principles are the foundations for all regulated firms. The introduction of a brand-new Principle isn't something to be taken lightly. The FCA is changing the whole direction for firms they regulate and expects them to follow suit.

Consumer Principle

The FCA is implementing a new Consumer Principle which has overarching cross-cutting rules, focusing on four outcomes.

The four outcomes

Products and services

Fit for purpose - advisers should be recommending products that are suited to the client's objectives.

Price and value

Fair value - is the client paying an appropriate fee for the service provided? Are they getting value for money?

Consumer understanding

Principle 7 of the FCA's Principles for Business is to "Communicate in a way which is clear, fair and not misleading". Consumer understanding is one step further as it focuses on the need and timing of information to customers.

Consumer support

With Consumer Duty, consumer support will be a stipulated requirement. Ensuring customers are getting the value they signed up to, not just having it written down on a fee agreement.

A firm must act to deliver good outcomes for retail customers

The FCA on Consumer Duty

It's not just about 'knowing' that you're doing right by your clients, it's being able to evidence it in your files.

The Consumer Principle focuses on a community mindset, encompassing everyone involved in the provision of advice, specifically the end customer.

The change here is going from knowing / believing you're putting your clients first to proving it - and showing how you've thought about their individual needs when considering the products and services you're going to deliver.

For many years the profession has been trying to move away from the stereotype of the adviser as a salesman – someone who'll sell their clients anything that will pay them a commission, whether or not it was suitable. With all the press surrounding bad DB transfers, bailouts of banks, complaints on investments / returns, it's no wonder there's a lack of trust in financial services.

The introduction of Principle 12 is all about firms' culture and behaviour.

There's no one singular document, or policy or procedure, to prove you've embedded this into your firm. But there are requirements for firms' boards, and some tweaks under SM&CR, which we'll address later in this guide.

Cross-cutting rules

The new Consumer Principle has overarching cross-cutting rules, which are:

- Act in good faith towards retail customers
- Avoid causing foreseeable harm to retail customers
- Enable and support retail customers to pursue their financial objectives

The cross-cutting rules aren't what we would typically describe as rules. They are more concerned with 'how' you achieve Consumer Duty.

The cross-cutting rules dictate the way in which the four outcomes are achieved, which are the 'what' you should be achieving for Consumer Duty.

Ensuring that firms are really looking at their culture and making this part of policy is to encourage clients to place trust back into the industry. It will also help clients understand that advice is there to help them reach their financial goals, not just there to sell them products they don't understand and, in some cases, may not even need.

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Implementation

- How do you design a policy that changes the fundamental culture of a business? And then how do you prove it?
- Firms must absorb Consumer Duty then look inward - something rational humans are typically very bad at doing personally, let alone professionally.
- We'll now dive a bit deeper into the four outcomes, considering the overarching cross-cutting rules, and what we suggest for firms in their implementation of these.

Products and services

Firms (distributors) need to

- Develop distribution arrangements for each product or service distributed (essentially, PROD)
- Obtain information from the manufacturer to understand the product or service, its target market and its intended distribution strategy (platform (and product) due diligence (PDD))
- Regularly review the distribution arrangements to ensure they're appropriate and, if they identify issues, take appropriate action to mitigate the situation and prevent any further harm (review of the above, plus a training and competency scheme)
- Share relevant sales information with manufacturers (relevant MI, which you'll be keeping for RMAR anyway!)

PROD – Hopefully this sounds familiar. PROD (Product Governance) isn't a new requirement for regulated firms, and it's not being explicitly mandated under Consumer Duty (in fact, almost the opposite). When looking at the product and services offered by regulated firms, firms should immediately be thinking about PROD. The final guidance does state the products and services outcome is wider than PROD alone, but it's a very good start.

Firms should review PROD, ensure it's up-to-date and really consider their service proposition, and the value of that proposition for the customer. Then document it. This could be PROD 2.0. Instead of TCF on steroids, how about PROD on steroids? Really dive into the detail.

We know lots of firms created a PROD because it was a regulatory requirement, but now we're urging firms (and so is the regulator) to go that step further into the detail of your client segments. The purpose of this is to ensure customers are only having products and services offered where they match their individual needs and objectives.

When we come to talk about price and value it's likely this will lead to further expansion of your PROD as it currently stands.

Vulnerability

It wasn't going to be long before a compliance guide mentioned vulnerability, especially considering the last two years, in which the number of potentially vulnerable clients has increased significantly.

The final guidance specifically tells firms to review their vulnerable customer process, referencing the FCA's guidance on it.

This includes how to:

- identify vulnerable clients
- handle vulnerable clients
- monitor vulnerable clients, and
- train your people on all of this. (This is how you start to build this into your firm's culture.)

Platform due diligence and centralised investment proposition

After PROD comes your platform due diligence (PDD) and your centralised investment / retirement proposition. PROD is almost the bread and butter, and your PDD and CIP are the fillings. All of these combined together make up your firm's proposition, which has to be documented. If we've learned anything over the last few years it's that if it isn't documented, it didn't happen!

As a distributor of products, you need to demonstrate you have:

- understood the characteristics of the product or service
- understood the identified target market
- considered the needs, characteristics and objectives of any customers with aspects of vulnerability
- identified the intended distribution strategy from the manufacturer, and
- ensured the product or service will be distributed in accordance with the needs, characteristics and objectives of the target market.

As part of the monitoring process, it would be worth building a section into your Training and Competency plan to ensure that advice staff are complying with PROD. This may mean that your KPI documents, file checking assessment, etc will need to be updated.

Reviewing your PDD / CIP should be an annual process at least, but you should also consider what events would trigger an ad hoc review of the documents to meet the product and services outcome.

You'll also need to create specific MI for recording this.

- PROD
- Platform due diligence
- Centralised investment proposition
- Training for current and new staff
- Training and competency review monitoring and detection policy

So, in summary - products and services is focused on which services you offer to clients, and why. The consumer understanding section later in this guide will look at how they are distributed.

> Value is about more than just price... ensure there is a reasonable relationship between the price paid for a product or service and the overall benefit a consumer receives from it.

Policy statement

Price and value

This is the outcome that has attracted the biggest reaction, specifically with the regulator's questioning around the value of ongoing advice.

Consumer Duty brings into the picture the concept of 'fair value' as the Policy Statement states.

With Consumer Duty, firms should conduct a 'fair value' assessment. The FCA prescribes this in their Consultation Paper, and they urge firms to look at:

- the costs firms incur to manufacture and/or distribute the product or service, including the cost of funding (e.g. for loans)
- the benefits received by consumers and the utility of the product or service to them
- the market rates and charges for comparable products or services
- possible savings from economies of scale which could be shared with customers
- possible returns from investment products or services, or assumptions on credit or other risk the firm is exposed to.

Fair value in itself is such a hard concept to define, because what's fair to one client isn't necessarily to another.

However, as long as you can document, and justify, what you feel is fair, and how that fairness is felt by the end customer, then you should meet the requirement.

The FCA hasn't put a ban on exit penalties as part of Consumer Duty, but it will penalise firms where this isn't deemed to be fair, or proportionate.

Ongoing advice

Many firms charge an initial adviser charge, an ongoing adviser charge and an annual review charge. It's just how things are done.

With the regulatory scrutiny on value, we're really urging advisers to reflect on this internally and question whether this is right for everyone.

It might help to ask questions such as:

- Do all my clients need an ongoing service?
- If yes, what value are they getting from my ongoing service?
- Is my flat percentage fee fair? Is the client paying 1% on their £10,000 assets versus 1% on their £1,000,000 assets getting the same value?
- Could we offer a different service or proposition? (If you can, get it in your PROD!)

Undertaking a fair value assessment and a review of your PROD, PDD and CIP will help you with this.

Then outside of your fees, what about the providers you're using? Consumer Duty doesn't mean you need to go for the cheapest platform on the market, but if you aren't, why not? Your platform due diligence needs to address this, and you need to have systems and controls in place to monitor this, ideally on an annual basis. Similarly with your investment proposition: what are clients paying for and is it 'fair'?

Consumer understanding

This is the big hitter in terms of Consumer Duty.

Gone are the days of 'I can't understand it, so it must be good'.

Clients nowadays may not have a specific understanding of investments or know about different tax exemptions, or even really know how their pension works, but they're bombarded with information about financial services from everywhere. Protection adverts on daytime television, crypto / investment apps on social media, letters from their employer pension provider that they don't open.

There's a lot of noise to cut through to understand exactly what they need to do to get what they want.

Through Consumer Duty, the FCA wants advisers to be the guide for clients through all the noise and to provide simple, clear options for them to consider. A firm's entire proposition should be built around providing clients with information that's suitable for them.

One way to evidence that you're clearly thinking about individual customers in all of your communications is to use some marketing principles. We know that this will seem strange in a regulatory guide, but let us explain...

Client segmentation (but not in the way you think!)

You'll already understand this in terms of PROD but there's a lot you can do with your existing data to prove that your communications are going to the right people. PROD introduced the concept of having a target market for all financial instruments, so now you should have a target market for all of your communications.

For example, in your client bank you'll have approximately three to six 'types' of client that will all require different streams of communications - you just have to identify them.

Dormant contact: Previously had advice but hasn't needed anything for a while. Needs to be reminded of the services you offer on the strength of previous work.

Ready for retirement: Self-explanatory, but this could also be split into sub-segments depending on the age of the retiree. Early retirees will have different needs to over 65s.

Already retired: Again self-explanatory but could be sub-segmented again by their general objectives or needs. There may be more vulnerable clients in this segment, so that should be another sub-segment.

Mid-life, young children: They may have protection needs, school fees, saving for children's futures as well as retirement / pension goals and so on.

Not ready yet - future client: They might be younger and / or might not have hit your minimum asset level yet, but it's good to cultivate a future client bank.

Obviously not all of these segments will be applicable to all firms, but it's recommended you take the time to look at your client bank and identify your own.

Each segment will have different needs and requirements, so this is the first step in evidencing you're truly thinking about who your communication is going to and what the content needs to be.

You shouldn't send out blanket newsletters, statements or articles across your contact database – each segment should have their own communications bank of the type and style suitable for them.

We mentioned earlier about pension documents that people file and don't open. You have to ensure your communications are clear and engaging and specifically for the consumer you specify. All client-facing documents that already exist will need to be reviewed in light of this.

The easiest way to do this is to develop suitable templates for communications per segment, as well as a process for using them.

Regulations

The regulator expects firms to have set processes in place for the production and approval of any communications that may be going to a consumer. Firms will already have financial promotions policies in place as well as an approval process. To apply this to Consumer Duty, firms need to look at any sort of communication, not just a promotion. And yes, we mean anything.

Firms should ensure all communications are clear, fair and not misleading, but also that the target market of the communication is considered in its design:

- Is this communication going to be seen by a vulnerable customer i.e. which segment?
- How have you addressed this?
- How are you monitoring communications to ensure the content is still relevant?
- What's your approval process?
- What management information do you have in place to review communications?
- Are your people trained to ensure what is considered clear, fair and not misleading?

The FCA has been explicit in that this doesn't just relate to communications of a written nature, and not just to clients. This is any sort of communication, to any customer, or potential customer.

The two actions we see as being mandatory are the construction of a communications policy (including templates for your applicable segments) and training for anyone involved in the distribution of communication.

Action one: The communications policy should be separate from a financial promotions policy, and should explain:

- the approval process for communications (where necessary)
- how it's reviewed
- guidance on 'clear, fair and not misleading'.

You should consider what communications MI you're going to need and how you're going to use this. Using your existing client data will help with this, but you need to ensure it's maintained going forward to keep all the data up-to-date. Again, this could feed directly into your training and competency scheme.

Action two: Anyone involved in the distribution of communications (which if we're broadening the definition of communications, is everyone) should be trained regularly. At a more senior level, whoever has control of the communications approval should also have a 'number two' trained to the same level to protect in any scenario where that person is off.

No matter what level of detail you choose to segment your client bank, this is clear evidence that you're considering the end consumer first.

Alongside this, the processes and controls that have been developed around your communications policy, as well as ensuring that all existing client-facing documentation is also reviewed, will stand you in good stead for Consumer Duty.

Consumer support

This outcome is all about the customer being the centre of every element of your business - it almost ties the three other outcomes together. It relates to the way your service complements your customers' objectives, ensuring their needs are met with products and services that match this, at every part of the relationship.

That last point is particularly important. The FCA is asking firms to consider supporting customers pre-sale, but also post-sale. Firms need to ensure that it's easy for customers to switch a product, leave the service, or make any changes to their service. All of this comes down to a regular, documented review of service propositions and a robust communications policy and procedure.

You need to consider whether clients are informed enough about the service you provide and what to do if they're not happy about it. Here we're specifically talking about reviewing your terms of business as well as your complaints handling procedure. For the latter especially, ensuring your teams are trained on the procedure.

Service may seem like one of those aspects of Consumer Duty that's hard to quantify. However it's really the culmination of all the other parts of the regulation. You could use the following to make sure you don't miss any of the main points we've mentioned throughout the guide.

Have you:

- reviewed your offering with PROD, PDD and CIP and decided on your general proposition?
- created your values and narrative based around the service you provide and how this adds value for the client?
- identified your general target market?
- had a look at your client bank and identified your client segments?
- reviewed your existing client-facing documentation and made sure it's fit for purpose?
- identified all of the touch points where a client (or prospect) may come into contact with your firm?
- got policies and procedures in place to back all of this up?
- updated your terms and conditions to make sure your team is on the same page?

Culture, governance and accountability

Moving on from the outcomes, there are some additional arrangements that the regulator mandates within firms. These broadly fall under 'culture, governance and accountability'.

We've already said that the FCA wants to see a client-centric culture as part of the Duty.

The FCA outlines the four drivers of culture as:

Purpose – the firm's purpose should be consistent with the Duty. Staff should understand how the firm's purpose is relevant to delivering good outcomes for customers.

Leadership – the firm's leaders should be competent and accountable, and they should demonstrate commitment to delivering good outcomes for customers.

People – delivering good outcomes for customers should be reflected in the way in which people are managed and rewarded. They should be trained to be able to deliver good outcomes for customers.

Governance – the firm's controls and key processes should be set up in a way that enables it to identify where the firm isn't delivering good outcomes for its customers, and it should have a strategy in place to understand and tackle the root causes and manage and mitigate poor outcomes.

The compliance with Consumer Duty must sit at a board and senior management level. Firms are expected to appoint a Consumer Duty champion who is the individual responsible for ensuring Consumer Duty is discussed at board level.

The regulator expects that a firm's board, or equivalent, should review and sign off an assessment of whether the firm is delivering good outcomes for its customers, which are consistent with Consumer Duty, at least annually.

There's an expectation for a member of the board, preferably a non-executive director, to be appointed with the responsibility of ensuring Consumer Duty is prioritised, and we would expect to see this on a statement of responsibility. Additionally the FCA has implemented a new individual conduct rule that applies to all members of staff: 'act to deliver good outcomes for retail customers'. Firms need to ensure their teams (where applicable) are trained on the conduct rules, and therefore need to ensure this new rule features within this training.

Monitoring arrangements

Consumer Duty has been developed significantly since its entrance into consultation paper land, and the FCA is mandating firms to ensure they monitor their arrangements under the new rules to appraise the regime.

Firms are expected to:

- Monitor and review the outcomes
- Identify where customers aren't getting good outcomes (and why)
- Have processes in place to adapt and change to address any risks or issues identified

We'd expect firms to be looking at things such as complaint logs to monitor this, as well as wider systems and controls.

In addition to the firm's monitoring arrangements, the FCA is also likely to monitor the implementation of Consumer Duty throughout the implementation period. We expect the FCA to be in contact with firms, potentially with surveys and questionnaires, to monitor progress. There's not been any formal reporting arrangement (i.e RegData) announced as part of Consumer Duty, but the FCA will be keen to ensure it's monitoring exactly how it's benefitting client outcomes.

Note: The FCA won't stop monitoring arrangements there, it will also use Financial Ombudsman Service data to review the impact of Consumer Duty on the volume and nature of complaints.

Summary

In reviewing the four outcomes, it's clear to see there's a lot for firms to do already. The FCA offers many examples of poor implementation in their finalised guidance, so we'd recommend everyone reviews this.

The initial impression that as Consumer Duty wasn't a tangible set of rules, it meant that firms already abiding by TCF didn't need to do anything has well and truly been discredited. What's evident is that any changes made internally need to be documented (as well as the discussions about those changes) and then in addition, processes need to be put in place to ensure you're reviewing the success of these changes.

Consumer Duty needs to be a firm-wide discussion, but specifically among senior managers. Firms need to have this on board meeting agendas (with actions having been signed off by October 2022). While the extension to the implementation date has given firms slightly more breathing room, it's not something that can wait until the last minute to prioritise. You need to be looking at this now and encouraging the start of the culture shift.

Resources

If you need more support, check out our Consumer Duty hub.

Produced in partnership with The Verve Group.

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