Grant Thornton

A guide to the FCA's new Consumer Duty

Sector view

September 2022

“We expect the focus on acting to deliver good outcomes to be at the centre of firms’ strategy and business objectives, and should be embedded in the same way, and receive the same level of ongoing attention, as financial performance, risk and strategy.”

FCA - A new Consumer Duty: Feedback to CP21/13 and further consultation

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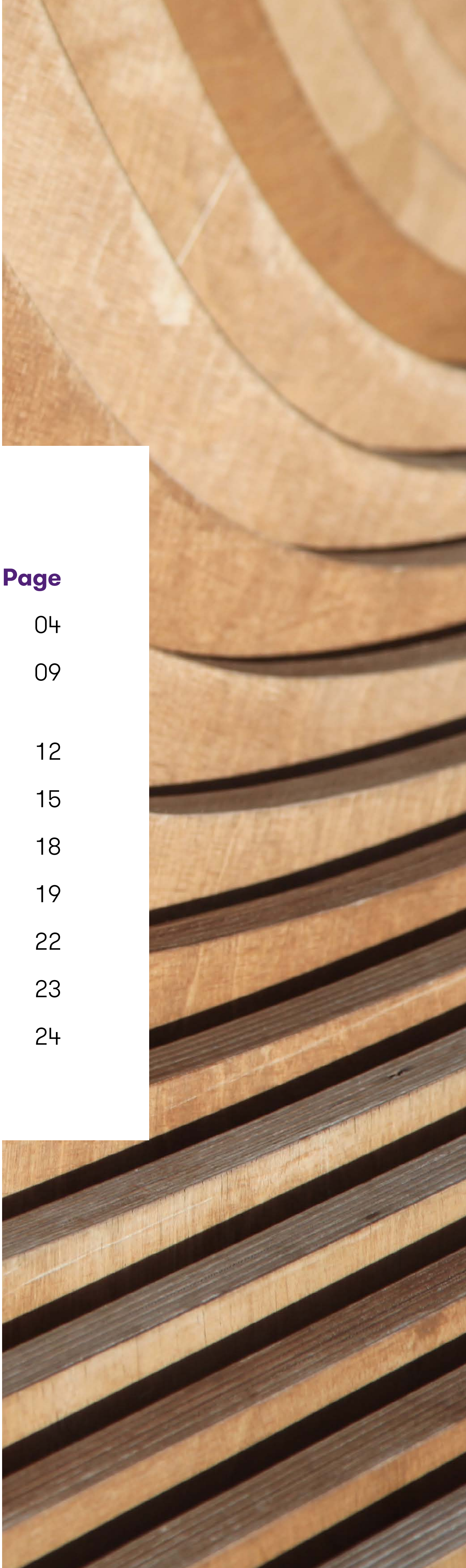


FCA Consumer Duty approach

By delivering on its planned implementation of a Consumer Duty, the Financial Conduct Authority (FCA) will follow through on one of its key priorities.

The new Consumer Duty stands out as one of the most significant developments in consumer regulation in recent years. For the first time, it provides the FCA with a single regulatory standard that can be applied across the breadth of the regulated financial services sector - regardless of product or service, and to all participants in the distribution chain.

The significance of the Consumer Duty can be seen from the fact that the FCA is revisiting and changing – for retail consumers – its Principles for Business, the very foundation of its entire regulatory infrastructure.

The regulator has determined that its Principles 6 and 7 – which have obligated firms to have regard for customers' interests and treat them fairly, and to communicate with customers in a way that is clear, fair and not misleading – have not generated sufficiently consistent good consumer outcomes. The FCA still sees too many examples of, in its view, poorly targeted and poor value products, misleading or inaccessible information, and other practices which hinder consumers' ability to act, or which exploit information asymmetries, consumer inertia, behavioural biases or vulnerabilities.

The FCA will therefore disapply Principles 6 and 7 – for retail customers – and replace it with a new Principle: the requirement to act to deliver good outcomes. The FCA is clear in its view that this new Principle, and the rules designed to enable it, encompasses all the associated requirements from Principles 6 and 7 (which will be retained for non-retail customers), whilst significantly raising expected standards. The Consumer Duty rules will codify, in a more granular and more readily enforceable way, expectations that have arguably existed and matured throughout the FCA's existence.

The FCA wants to move the financial services industry from a world where firms must demonstrate that they treat customers fairly, to a world where this fair treatment leads, consistently and demonstrably, to good outcomes. This is a significant change, albeit an evolutionary one, part of a continuum focused on fairness, value and culture. The Principle that firms must act to deliver good outcomes will require firms to define, in an actionable and measurable way, what 'good outcomes,' 'fair value' and 'foreseeable harm' mean – for their products, services and customers – in a way and to an extent not seen before.

While some commentators see this as an unnecessary iteration of "Treating Customers Fairly" (a concept that is well past its sell-by date), this misses the point of a material change in the regulatory toolkit, which is designed to impact individual firms very differently and will see the FCA far better equipped to supervise the complexities and inter-relationships of the modern financial services market.

Key deadlines

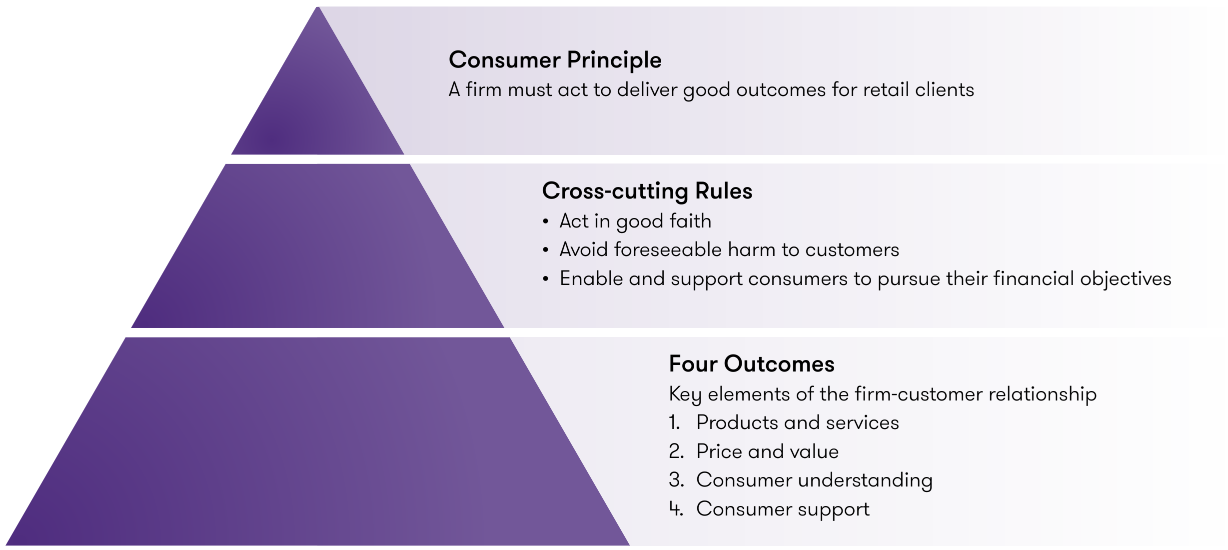
All senior management teams should also be very mindful of interim dates that the FCA has set out, to ensure that firms have no doubt as to the expectations on them during the implementation period.

- **October 2022** - boards should have agreed implementation plans and oversight of delivery
- **April 2023** - manufacturers to share key information with distributors three months ahead of the implementation deadline
- **31 July 2023** – new date to implement the new rules for new and existing products or services that are open to sale or renewal
- **31 July 2024** - new date to implement the new rules for closed book products or services

Core components

The Consumer Duty is made up of three key elements: Consumer Principle, Cross-cutting Rules, and the Four Outcomes.

The structure



New requirements

A Consumer Principle

The FCA set out in the Principles for Businesses, stating that "A firm must act to deliver good outcomes for retail clients." After much debate across the industry as to a preferred wording for the Principle, and how this does or does not replicate aspects of the pre-existing Principles, what it certainly does is move expectations on firms away from more passive consideration of the treatment of customers to a much more deliberate requirement for firms to take appropriate action.

While questions will remain for firms as to how exactly the boundaries of the Principles will apply to different customer and client segments, this new Principle should prove an easier supervisory tool for the regulator to use more broadly across complex distribution and business models. A critical area of importance for firms and the FCA will be the need for early clarity on what does, or does not, amount to a 'good outcome' in any circumstance and the subjective nature of this kind of definition will require constructive dialogue and careful communication by all parties.

Cross-cutting Rules

With the intention of clarifying and strengthening the standards of conduct that it expects under the Consumer Principle, the FCA has set out three Cross-cutting Rules that will require firms to:

- act in good faith towards retail customers
- avoid causing foreseeable harm to retail consumers, and
- enable and support retail consumers to pursue their financial objectives

While the FCA is not proposing a specific Cross-cutting Rule focused on consumers in vulnerable circumstances, the FCA has made clear its intent that consideration and appropriate treatment of such consumers should be embedded at every part of the customer journey.

The Four Outcomes

The rules and guidance then go on to outline more detailed expectations for the key elements of the firm-consumer relationship:

1. Products and services

Different requirements are specified for firms depending on their role in the distribution chain, as either a 'manufacturer' or 'distributor.'

Manufacturers will need to:

- develop an approval process for products or services
- identify a target market of consumers for whose needs, characteristics, and objectives the product or service is compatible
- consider if there are any consumers with characteristics of vulnerability in the target market and take account of any additional or different needs of those consumers
- test the product or service and ensure it is designed to meet the needs, characteristics and objectives of the target market
- select distribution channels that are appropriate for the target market and provide adequate information to distributors to enable them to understand the product or service and the target market, and
- regularly review the product or service and its distribution, and take appropriate action to mitigate the situation if they identify circumstances that may adversely affect their customers.

Distributors will need to:

- develop distribution arrangements for each product or service distributed
- get information from the manufacturer to understand the product or service, its target market, and its intended distribution strategy, and
- regularly review the distribution arrangements to ensure they are appropriate and, if they identify issues, take appropriate action to mitigate the situation and prevent any further harm.

2. Price and value

The rules require firms to offer fair value to consumers.

When assessing whether the price of a product/service provides fair value manufacturers must include consideration at least of:

- the nature of the product or service, including the benefits that will be provided or that consumers may expect, and their quality
- any limitations that are part of the product/service
- the expected total price customers will pay, and
- any characteristics of vulnerability in the target market for the product or service

Distributors will not be able to distribute products or services unless they are satisfied that their distribution arrangements are consistent with the product or service providing fair value. The rules set an expectation that they must obtain information from the manufacturer to understand the intended value of the product or service and consider the impact that distribution arrangements, including remuneration, can have on that value.

3. Consumer understanding

The FCA is seeking to ensure that firms' communications support and enable consumers to make informed decisions about financial products and services, with a particular focus on consumers being given the information they need, at the right time, and presented in a way they can understand.

The rules require firms to support retail consumer understanding so that their communications:

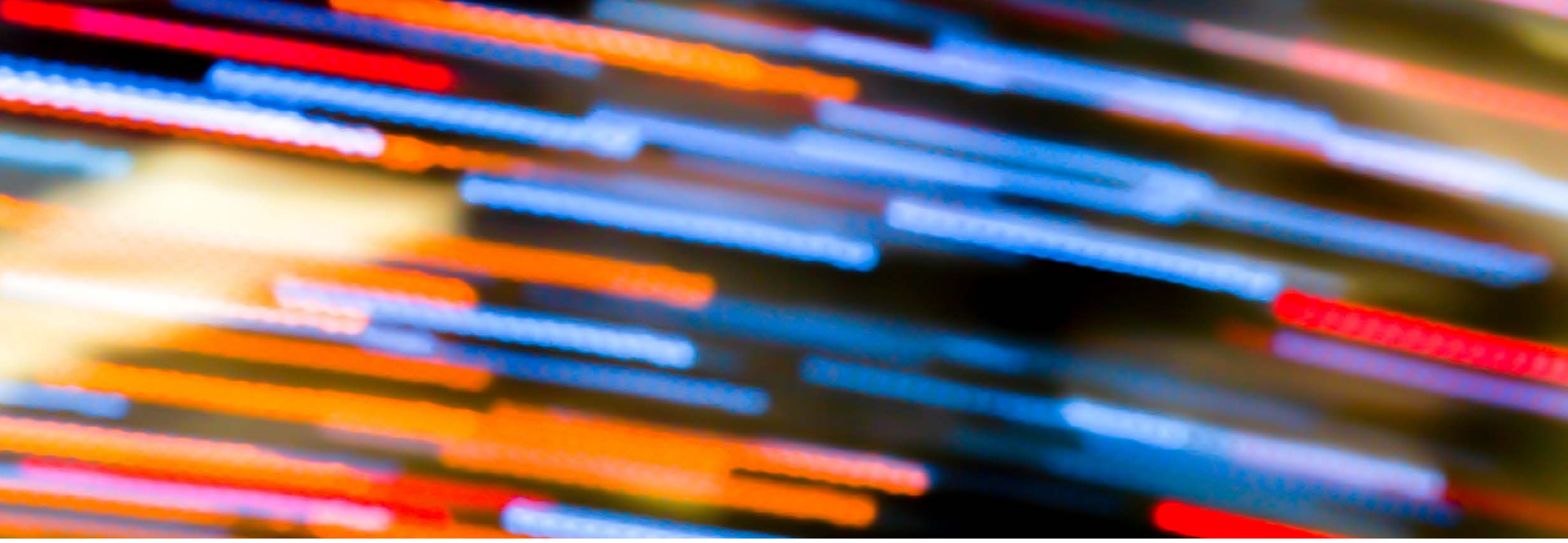
- meet the information needs of customers
- are likely to be understood by the average customer intended to receive the communication
- equip customers to make decisions that are effective, timely and properly informed
- communicate information to retail customers in a way which is clear, fair, and not misleading
- tailor communications considering the characteristics of the retail customers intended to receive the communication (including any characteristics of vulnerability), the complexity of the product, the communication channel used, and the role of the firm
- provide information to retail customers that is accurate, relevant and on a timely basis
- tailor communications to meet the information needs of individual customers and check the customer understands the information, where appropriate, when a firm is interacting directly with a customer on a one-to-one basis
- monitor, test and adapt communications to support understanding and good outcomes for retail customers

4. Consumer support

The FCA's focus on this outcome is driven by a desire for firms to provide a level of support that meets consumers' needs throughout their relationship with the firm, with a particular expectation that customer service should enable consumers to realise the benefits of the products and services they buy and ensure they are supported when they want to pursue their financial objectives. This is significant and broadens the UK regulators' historic focus on firms' conduct at point of sale to more clearly set high expectations around all interactions with a consumer throughout the product and service lifecycle.

The rules require firms to ensure that:

- they provide an appropriate standard of support to retail customers such that it meets the needs of customers, including those with characteristics of vulnerability
- retail customers can use products as reasonably anticipated
- retail customers do not face unreasonable barriers (including unreasonable additional costs) when they want to pursue their financial objectives, and
- regularly monitor whether they are providing an appropriate standard of support that meets the needs of – and does not disadvantage – retail customers, including those with characteristics of vulnerability



Application across the distribution chain

The FCA has articulated its expectations for firms involved in different stages of the distribution chain for products and services. Its intention is for the new requirements to apply proportionately, taking account of the firm's role in the chain, the nature of the product or service and the characteristics of the consumers they are dealing with. All authorised firms involved in distributing products and services to retail investors, from manufacturers to end-distributors, will need to comply with the Consumer Duty for their own activities. The FCA has also indicated that it would generally expect firms with a direct relationship with the end user to have the greatest responsibility under the Consumer Duty. However, all firms that have an impact on consumer outcomes will need to consider their obligations carefully, including how they interact with each other.

This will include all firms that have a material influence over the design, operation and distribution of retail products or services, those preparing and approving communications that are to be issued to retail clients, or those having direct contact with retail clients on behalf of another firm, such as firms involved in debt collection or mortgage administration. This is likely also to bring into play some wholesale firms, who would otherwise be outside the scope of the new Consumer Duty. The example the FCA gives to illustrate this point is that of an investment bank which is brought within the scope of the new proposals because it designs structured products for sale to retail investors.

While the FCA's Product Intervention and Product Governance Sourcebook (PROD) already contains specific requirements for both manufacturers and distributors, the new Consumer Duty builds on this by setting out the FCA's evolving expectations, while "upping the ante" for those firms caught by it. The requirements for designing products and services for clearly defined target markets and distributing them through appropriate channels will be familiar. So, too, will be the focus on vulnerable customers, and the FCA's requirements for approving, monitoring, and testing products and services, and providing adequate information to distributors to help them understand their nature and which target markets they are intended for - manufacturers should be doing this already.

For the same reason, distributors shouldn't be too phased by the proposed need to develop distribution arrangements for each product or service, obtain information from the manufacturer to understand the product or service, the target market and its intended distribution strategy, and to regularly review the distribution arrangements to ensure they are appropriate. These are familiar themes. As now, both parties will need to learn from any issues they identify and take appropriate action to prevent harm going forward, but the new Consumer Principle, which raises the standard of conduct expected, means there is nowhere for non-compliant firms or individuals to hide.

All firms within scope will need to take a fresh look at their communications to retail consumers and the service and support they provide, as part of implementing the new requirements. But perhaps most significantly, it is the assessment of fair value that is likely to require a new mindset. All parties will need to reflect on the role they each play and, more specifically, the value their presence in the distribution chain brings for the consumer. Manufacturers will be expected to assess fair value at the product or service design stage, and distributors at the point-of-sale. Distributor firms will need to assess whether their own charges represent fair value and, as they are likely to the last link in the chain, should also consider whether the overall proposition provides fair value. This represents a major step up in terms of obligations for distributors and a practical challenge too - assessing fair value across the whole chain will require significant data collection and analysis. Moreover, all parties will need to assess fair value on an ongoing basis and not just at the design stage. In extremis, if firms can't objectively justify and demonstrate added value from their involvement, they may just find a valuable income stream has been closed to them.

Consumer Duty and its impact across the business

One of the greatest challenges to firms seeking to ensure Consumer Duty compliance is the wide scope of the obligations and the resulting impact on many parts of the business model.

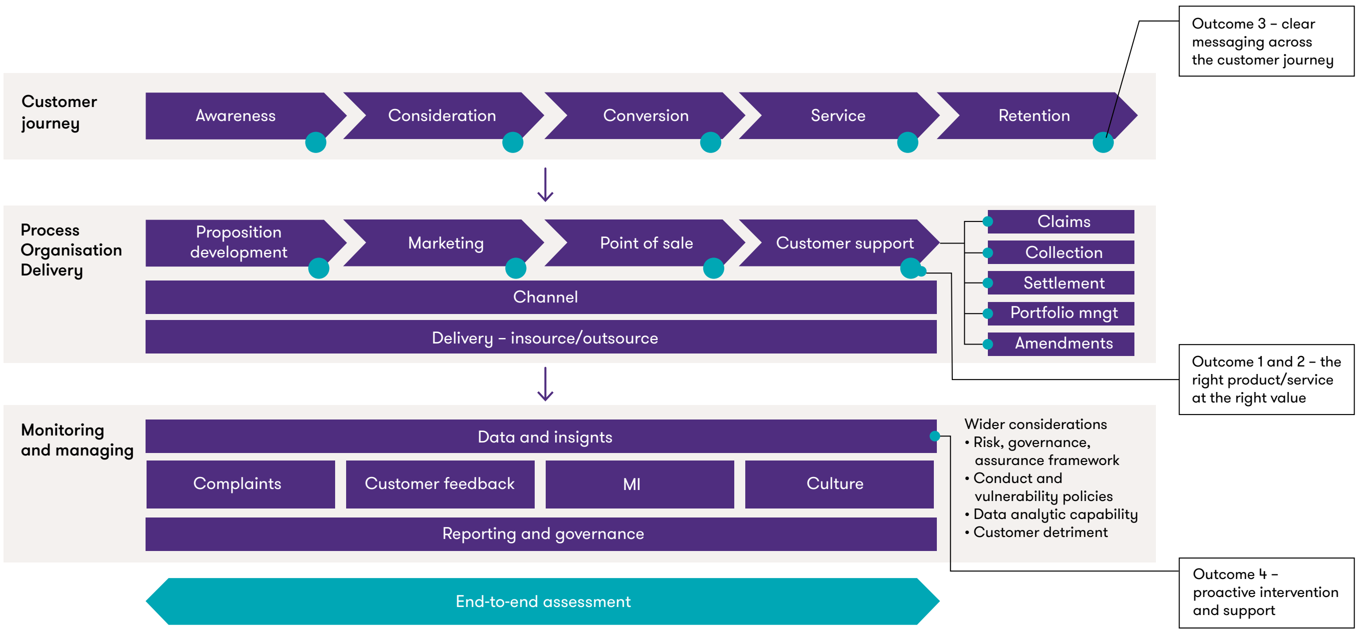
The diagram below shows how many different aspects need to be considered in driving good customer outcomes, as understood and defined by a firm. These include understanding the relationship between the customer journey, the propositions, the business model (processes, channels, and delivery mechanisms) and monitoring and managing the business - while aligning it to the underlying controls, governance and policies sets.

When assessing what needs to be undertaken, understanding and assessing a firm's customer journey allows a business to:

- look at itself with a customer centric lens,
- understand what is important to the customer and what constitutes a good outcome at each touch point

This in turn ensures a better understanding of the types of intervention which may be applied to support the customer and drive out a better overall outcome. Leveraging data insights to achieve this successfully (and to evidence the right outcomes) are central to its success.

Finally the management of change necessary must be both considered and coordinated given the extend of Consumer Duty impact across the customer lifecycle.



Sector view: insurance

Many of the core ideas and themes underpinning Consumer Duty will already be familiar to firms in this sector, which successfully implemented the Insurance Distribution Directive in October 2018. The Customer's Best Interests rule and product oversight and governance requirements in particular bear striking similarities to the FCA's thinking regarding Consumer Duty.

Similarly, there are clear parallels between the latest general insurance pricing practices reforms and the Consumer Duty's price and value outcome. However, just because firms already comply with existing, sometimes similar requirements, they should be wary of assuming that this means there will not be additional work to implement the full requirements of the Consumer Duty rules.

Many challenges will not be unique to the insurance sector. Identifying the scope of Consumer Duty and applying this to each firm's business model and defining key terms such as 'fair value', 'good (and poor) outcomes' and 'foreseeable harm' in a meaningful and practically applicable way are challenges faced by financial services firms across all sectors.

As with any widespread regulatory change, the long and complex distribution chains that can be common in the insurance industry present a unique challenge. Firms must ensure they clearly identify each party's roles and responsibilities, quantify the value they bring to customers when compared to their remuneration, and strike an appropriate balance where firms maintain adequate oversight of the chain without excessively 'policing' other parties in the chain.

The FCA's focus on consumer understanding and consumer support builds on their existing ideas around clearer, smarter customer communications and highlight the challenges for firms of providing customers with sufficient information in an easy to interpret manner, which allows them to understand what are often quite complex products.

Products and services

The products and services outcome focuses on product governance from design to withdrawal including changes to the product. It applies to new, existing, and closed products. Insurance firms will have the option to rely on compliance with the product intervention and product governance sourcebook (PROD) to demonstrate compliance with this outcome. However, firms will have to actively opt for this reliance. The difference from the current requirement is that this process will now need to explicitly consider foreseeable harm and ensure that the other three outcomes have been considered for each product and service.

Firms should undertake a gap analysis of their current PROD compliance to assess the extent to which their practices demonstrate compliance with this outcome and associated Cross-cutting Rules.

The scenario below illustrates poor product governance practices and why:

An insurer is considering the development of a new home insurance product. Its underwriting team has determined that the target market for their new home building and contents product will be anyone who has a home.

The underwriting team decides to include garden equipment, non-permanent buildings and cover for students not living at the insured address.

The underwriting team has not undertaken a review of their customers' needs, nor considered testing the product with a sample of their target market. The product decision making prior to the launch has been focused on how the product will be sold to achieve the greatest margin.

The underwriting team follows the approval process that includes legal, chief underwriting officer and marketing sign-off.

Issues:

1. The product sign-off process lacks counterbalance because the decision making is solely driven by the profit centre that will benefit from the sale of the product.
2. There is no consultation requirement with the second line of defence. The identification of the target market is too broad and not focused on identifying who the product would not be suitable for. This is likely to lead to poor demand and needs assessments.
3. The underwriting team has not considered the servicing of the product once sold, for example changes to the policy cover details or cancellation.
4. The underwriting team has not considered how the firm will monitor that the product is sold to the correct target market.

A good practice would have been to consider the following questions when establishing the product and service framework:

1. Is the scope of the product and services framework appropriately defined and understood?
2. Are the right departments and functions involved in the review and approval process to provide sufficient challenge?
3. How will the firm ensure that their products and services meet true customer needs, and that foreseeable customer harms are appropriately considered and mitigated?
4. How will the products and services be monitored and what indicators and thresholds should be used as warning signs?
5. Who is responsible for the day to day oversight of the products and services across the customer journey (the other three outcomes should be considered)?
6. How does the firm demonstrate that the board has appropriate oversight of its products and services?
7. How does the product and service framework support the annual board attestation?

Price and value

The price and value outcome set out in the Consumer Duty clearly builds on thinking already set out in the FCA's General Insurance pricing reforms. To the extent that firms successfully implement the fair value assessments mandated by these reforms, they should therefore be well-placed to satisfy their obligations under this outcome of Consumer Duty.

Key considerations when assessing the value of insurance products will include ensuring that all elements of value have been considered holistically, including both financial and non-financial aspects and ensuring that all parties involved in the distribution chain are providing an appropriate level of value to justify the remuneration that they take.

Consumer understanding

For contractually-based products such as an insurance policy, ensuring that customers understand the terms and conditions of the product they have purchased is vital. However, when considered against the cold reality that very few customers will read the policy wording in full, this presents a significant challenge. Summaries, such as those given within Insurance Product Information Documents, or using welcome letters to draw customers' attention to specific key terms, can be a useful start. However, when set against the increasing amount of mandatory information that firms must provide – including renewal pricing transparency, CMA information about no claims bonuses, and information about automatic renewal – it becomes challenging for firms to avoid overwhelming customers with excess information. Consumer understanding of insurance products is further made more difficult by the complex way these are sometimes distributed - which can include lengthy and convoluted distribution chains or the 'bundling' of combinations of insurance products from different providers.

It is therefore vital for firms to ensure that they communicate with customers in a sufficiently clear manner at the point of sale, so that customers truly understand the product they are purchasing and can make an informed decision. The precise challenges of this will vary depending on the sales channel employed and whether a sale is advised or non-advised. However, in all circumstances, simply relying on providing the customer with extensive quantities of written information to review is unlikely to meet the FCA's expectations under Consumer Duty.

This outcome does not only apply to the point of sale of a product. Firms should also consider how they explain the reasons for their actions during post-sale customer communications, for example in the event of a premium increase following a mid-term adjustment or a declined claim. In addition to furthering customer understanding, this would also help to increase transparency throughout the industry and, therefore, could help to repair its reputation among the public.

Consumer support

Firms should ensure that every element of the consumer journey is easily accessible and there are efficient operational procedures to support customers through the life of a product, including for those consumers with characteristics of vulnerability. We anticipate that for insurance firms the biggest consumer support challenge will be in post-sale support. The FCA is particularly concerned about post-sale processes, such as switching, claiming and complaints, and wants these to be as smooth as sales processes. Excessive friction which makes life hard for consumers will attract attention from the regulator.

In considering consumer support, firms should identify processes which might be hindering good outcomes and address any system deficiencies or unreasonable barriers to accessing support (for example, under-resourced customer service call centres, slow service, difficulty identifying contact details). For some firms this may mean moving focus from pre-sale interactions to looking at service levels or practices that might hinder making a claim or exiting from a product that is no longer needed.

When assessing the standard of end-to-end support available through the life of a product, firms must be mindful that any assessment will apply whether customer service functions are internally managed or outsourced to a third party. Providers of insurance products need to remember that they will be responsible for any remedial action required resulting from shortcomings of third-party suppliers – a common practice where add-ons to policy coverage are provided by different firms. Firms will also need to ensure that their customer service and support processes do not disadvantage the end beneficiaries and are not simply geared to policyholders who may be commercial freeholders.

Sector view: banks, building societies and consumer credit firms

Consumer Duty represents a significant shift in how the FCA regulates the retail sector. Its intention is to encourage all regulated firms, including banks, building societies and consumer credit firms, to deliver good outcomes for, and prevent foreseeable harm to, their customers. Consumer Duty will apply to both manufacturers and distributors, with differing, but increased, responsibilities for each.

Products and services

Under the new proposals, banking and lending products and services must be designed to provide fair value and meet the needs of specific, well-defined, customer groups. They should be carefully targeted and distributed through appropriate channels to ensure that they are meeting the needs of those target groups. Not surprisingly, given the FCA's focus on vulnerable customers, the new proposals also place additional obligations on firms to consider those who are, or may become, vulnerable during the customer relationship. Firms operating in the banking sector will therefore not only need to ensure their products and services are designed to take account of additional needs, are flexible and accessible to all, but that they are consistently meeting those needs in practice. This places much more onus on post-sale monitoring and the collection of data to understand how these products and services are performing than has hitherto been the case.

Price and value

Manufacturers of banking and lending products will need to identify the business activities that have a direct or indirect impact on retail clients and should develop capabilities to carry out detailed, quantified value assessments of all their relevant products and services. They will need to develop new approaches for assessing fair value for the full range of products they provide, e.g. what is a fair rate of return for a deposit-taking savings product, or what is the reasonable total cost to the customer of a lending product. Fair value could be considered using a range of measures, for example by assessing whether prices are excessive on a cost-plus margin basis, benchmarking rates of return between different customer cohorts or undertaking quantitative benchmarking of charges against similar products in the market. But it's not just about price. Firms will also need to consider customer benefits and other non-tangible factors such as product utility and convenience, any restrictions on use and the impact on vulnerable customers when assessing value.

Manufacturers' approaches to fair value assessments will require them to factor in the roles of other firms in the distribution chain, such as mortgage brokers, and the value they add at each stage of the process. Similarly, distributor firms should assess whether their own distribution charges represent fair value. The FCA has also stipulated that where more than one firm is involved, the final firm in the chain should consider whether the overall proposition provides fair value.

Consumer understanding

The Consumer Duty rules will require firms to support customer understanding by ensuring that their communications enable retail customers to make effective, timely and informed choices. Firms will need to ensure that customers have access to the information they need to make the right decisions at all stages of the customer journey. This includes, for example, marketing materials, product literature, welcome packs, annual statements, late payment and arrears notifications, and information issued at the end of a product term. While firms will still need to issue communications as prescribed by existing legislation - eg by the Consumer Credit Act or the European Standard Information Sheet (ESIS) for mortgages - they should think more widely about the purpose of their communications as a whole and how these can help deliver good outcomes for customers.

When firms are directly interacting with retail customers on a one-to-one basis, eg during a telephone call or online chat, they should tailor their communications to the needs of the customer and take steps to ensure that the customer not only receives the relevant information, but that they actually understand it. This requires more than tick-box compliance. While firms may already have the capability to design and implement effective customer communications, the new Consumer Duty requires firms to check that these can be understood by the consumers they are targeting, including specific subgroups of customers. Firms are likely to need to set up new processes to test customer understanding and monitor and adapt communications to support good customer outcomes.

Consumer support

Consumer Duty will see firms needing to demonstrate good consumer support outcomes for clients. Data should be available to clearly document the quality of support provided to consumers and enable senior management to make changes where they identify areas of weakness. Firms must be confident that all consumers can access support if required, at every step of the consumer journey and by any reasonable means. It should not be difficult, or costly, for customers to contact firms. Moreover, good levels of support and service should be available to consumers regardless of the length of time they have been a customer of the firm. A consumer should, without any unreasonable barriers, and through appropriate channels, be able to access cash and savings, make transactions, exit a product, and expect to be fully supported when they experience fraudulent activity on their account. The FCA's proposals do recognise that there are times where delays in consumers getting support will not be unreasonable, but expect firms to minimise and manage these, for example prioritising dealing with urgent requests and/or support for vulnerable customers. Where overdrafts, loans and mortgage products are provided, firms should provide care and support for consumers who have concerns about repayments.

It will therefore be incumbent on firms to perform robust risk assessments at all stages of the customer journey to identify potential consumer risks and to prevent them crystallising. Firms that can truly put themselves in the shoes of their customers, think broadly about what good outcomes look like, recognise potential sources of harm to consumers and manage the risks effectively will be best placed to achieve good outcomes in practice.

Avoiding foreseeable harm

One aspect of ensuring good outcomes is minimising the risk of harm. There are many scenarios where there is a potential for adverse impact on the consumer and where it should be relatively easy for firms to take pre-emptive action to avoid this. For example:

- Mortgage incentive periods ending: is sufficient consideration given to advising and forewarning customers that their existing mortgage deal is coming to an end, for example when a fixed rate defaults to a higher standard variable rate after a discounted incentive period? Have customers been given sufficient information for them to understand their options (both with their existing lender and in the wider market), and early enough to fully consider those options so that they can make the right decisions and take appropriate actions before their payments increase?
- Termination of a product: it should be just as easy for a customer to change, switch or terminate a product they no longer need as it is to buy or subscribe to a new product. This is likely to mean that firms will need to put in place post-sale support mechanisms that are at least as efficient as those they have in place for opening new accounts, taking out a new investment product or obtaining credit. Similarly, firms will need to think through the full implications when they are proposing to withdraw an existing product, such as whether they can offer a similar, better value, product or whether there are other alternatives available to their customers in the wider market
- Behavioural biases: firms need to be cognisant of behavioural biases that they could inadvertently exploit if not front of mind. A good example of this is the tendency of consumers to over-borrow and under-pay on credit cards. Customers may be over-confident or take a short-term view of their ability to make mortgage payments for the full duration of the loan. Due to inertia, others might stick with sub-optimal or higher priced products simply because they are unwilling to change products or shop around, eg for lower cost loans or to obtain higher interest rates on their deposits. Firms' failure to recognise these behaviours and take positive action to address them could lead to poor outcomes and indirectly cause consumer harm
- Branch closures: the FCA expects firms to assess how planned closures of branches or ATMs will affect customers, particularly those in vulnerable circumstances, and to make appropriate arrangements to ensure their needs are still met. For example, this includes assessing what alternative services are available from other providers, or what steps could reasonably be taken to meet their needs

Sector view: investment management

The investment management industry is already subject to numerous regulations that will coexist with Consumer Duty, including value assessments, PROD, and fund/product regulations. Consumer Duty can be seen as an overarching set of regulatory rules, filling any gaps within existing regulations. The existing regulations were designed to reduce the chances of customer harm and ensure the customer is the firm's focus within both the corporate culture and throughout a product's lifecycle.

The overall objectives of existing regulations and the Consumer Duty are similar. As a result, firms within the investment sector may not consider the rules to have a significant impact on their business model, products, or the way the firm is currently run. However, one of the key changes following the implementation of the Consumer Duty will be a focus on firms demonstrating compliance through governance structures, testing, and data. This means firms will need to be more proactive, not only with their focus on good customer outcomes, but also in proving the steps they have taken.

Consumer Duty makes it clear that the supervisors of firms will require them to provide the FCA with the information it requires to assess the firm's compliance. The degree of confidence a firm can provide to the FCA that the Consumer Duty rules are being appropriately considered will be paramount to demonstrating that the interests of customers are embedded within the firm's culture. Demonstrating compliance is an ongoing responsibility for firms, therefore it's important to test this regularly (at least annually) and reconsider when the terms and conditions or benefits of a product or service are altered.

As a result of Consumer Duty, there will be clearer linked responsibilities for a product distributor and manufacturer, particularly where a manufacturer does not have a direct relationship with the client.

Manufacturers will now need to consider the total cost to the end client (including distributor fees) and whether existing distributor relationships are compliant. This may result in termination of some existing arrangements where high distribution fees undermine the value of the product. The Consumer Duty has a broad scope and, although forward looking, it covers all in force past business, where the FCA may also consider there to be customer harm. As a result, firms will not only need to consider the impacts on new business, but also existing and closed business. However, the FCA has made it clear that the prevention of customer harm is the priority, and a firm does not need to alter their contractual rights on existing business if alternative methods are possible.

Due to technological improvements, the ability, and timescales to purchase, switch or exit an investment product are quicker and easier than ever before. By design, legacy products are less likely to offer the same ease, flexibility, or levels of customer service. The competition in the marketplace has also increased significantly in the last decade, lowering costs.

Customers already have access to readily comparable data; however, the Consumer Duty takes this one step further, with a focus on further reducing the burden on customers to research, filter and make investment decisions.

This is consistent with the fundamental aim of taking *"proactive steps to empower consumers to make good choices by establishing an environment in which consumers can make decisions in their own interest and realise their financial objectives."*

To appropriately consider the impact of Consumer Duty, firms will need to review how they currently operate and consider where changes may need to be made.

The impact of this on each firm will vary significantly, but gap analysis is likely to be a key first action to establish where they may be falling foul of the rules in governance, design, value, communication, or support. Alongside this, firms will need to incorporate outcome testing across all elements of a customer journey. This will not only need to identify where products and customer outcomes are compliant or not with the Consumer Duty, but also ensure the data is measurable, and records and management information (MI) are complete and updated regularly.

Products and services

Consumer Duty applies to firms who design, operate, or distribute retail products and services. The scope of the duty therefore covers indirect relationships with retail customers, such as institutional investors, like asset managers, with product distribution channels that include retail investors.

Asset managers will therefore need to continue to ensure that new products are subject to appropriate targeting, testing and consideration of the intended customers' needs, characteristics, and objectives, rather than their own business needs. They and their distributors will also be required to share relevant data and information so that all parties can review the distribution arrangements and consider the whole distribution chain.

Although forward looking, Consumer Duty will apply to both existing products that are still being sold to customers and products that are no longer being sold or renewed. Closed business, particularly when managed independently from new or existing business, may not have had the same attention from firms. The implementation of Consumer Duty should bring this to the forefront of a firm's testing and analysis when identifying whether the product or service is compliant and taking appropriate action if necessary.

Investment management firms will also need to consider its impact on their business model and strategy, which may require adjustments to existing MI to ensure that the Board has sufficient oversight. Firms will need to keep a close eye on complaint data, which will continue to be a key focus of the FCA to demonstrate that the regulations are being appropriately considered.

Price and value

Whether products are providing consumers with fair value is not a new concept for many firms within the investment management sector. Since September 2019, Authorised Fund Managers (AFMs) have been required on an annual basis to conduct and publish the results of an 'Assessment of Value' (AoV) for each scheme that they manage.

Some of the minimum factors that must be considered as part of the AoV are quality of service, performance of the scheme, costs of providing the service, savings or benefits achieved via economies of scales and comparable market rates and services. These are all factors that the FCA expects to be considered as part of the new Price and Value Consumer Duty Outcome. AFMs who are therefore already complying with the AoV requirements will have a head-start when it comes to demonstrating compliance with the Price and Value Outcome requirements.

There are, however, three important factors that firms within this sector will need to bear in mind:

1 Not all firms within this sector are required to perform an AoV. Many of these Price and Value requirements will therefore be completely new to some firms
2 In July 2021 the FCA made it clear that it was not satisfied with how several firms were performing their AoVs. The FCA found that firms were making assumptions that they could not justify, a failure to consider all the minimum factors as part of the assessment and insufficient challenge from governing bodies and Boards
3 The Price and Value Outcome requires firms to go further than the AoV requirements. Specifically, the Price and Value rules place different requirements on product manufacturers and product distributors, and firms must consider the value provided throughout the distribution chain as well as whether any consumer vulnerabilities impact on the value they receive from their products or services. Furthermore, value must be assessed for a "reasonably foreseeable period" which will depend on the type of product under review and the expected length of time that the consumer will hold the product

It is clear that, while AFMs who have performed a robust and comprehensive AoV may be in a strong position to evidence compliance with many of the new Price and Value Outcome rules, this certainly won't be the case for all firms within this sector.

Regardless of whether an AoV has or hasn't been performed, Consumer Duty goes beyond the AoV requirements, which means all firms within this sector will need to either revisit their current assessments, or design and implement new ones from scratch.

Consumer understanding

The Consumer Duty rules will hopefully give customers a clearer view of all transaction costs and charges, which they may not be aware of or because its not made sufficiently clear. Where full cost disclosures are made, there can be inconsistencies between different documents and websites, and customers can therefore find the information difficult to understand.

ESG and sustainable funds are a fast-growing segment and its important that funds marketed with a sustainability and ESG focus describe their investment strategies clearly. The FCA has raised concern over the need for improving quality and clarity to the end consumer.

Consumer support

Under Consumer Duty, investment management firms are required to consider the support their customers need and make sure their customer service meets those needs. In this regard, they will need to ensure that the support provided to their clients is proportionate and reasonable. Processes should be reviewed to ensure that consumers are able to redeem or switch investments without facing unreasonable barriers (such a long waiting times).

Consumer Duty calls for firms to support the customer in a way that takes their needs into account by designing processes that allow the consumer to realise the benefit of a product or service and act in their own interest, without facing unreasonable barriers (including additional costs).

Firms will need to monitor the quality of support and ensure they do not disadvantage groups of consumers. For example, investment managers that do not allow third parties access to a client's information directly may cause delays and stress for that client if they are looking to receive advice or redress. Such practices may cause foreseeable harm for a consumer who is recently vulnerable and needs external support with their financial affairs. The new guidance indicates that firms will fall short of the regulators expectations if the way they interact with other firms has a detrimental impact on the support and outcomes received by customers.

Where a customer requires regular reviews to re-balance their portfolio the provision of these should be timely and accessible. Where consumers are not able to re-balance in line with expectations, there may be harm from investments not being aligned to attitude to risk or changing objectives. While there are circumstances where interim reviews may not be possible, firms should be able to demonstrate that their processes can reasonably support and empower the consumer.

Vulnerability

It will come as no surprise to firms that the FCA's focus on achieving good customer outcomes for vulnerable customers continues to be a prevalent focus area for the regulator.

This remains consistent with the Consumer Duty proposals, which arrived shortly after the long awaiting guidance on vulnerable customers.

Consumer Duty builds on the vulnerability guidance published by the FCA in early 2021 by explicitly setting a higher standard of care across all retail markets and asking firms to consider the needs of customers with characteristics of vulnerability, including 'how they behave, at every stage of the product or service lifecycle.'

Firms dealing with retail clients (indirectly and directly) should consider their approach to identifying and supporting vulnerable customers and use this opportunity to review, enhance or develop their vulnerable customer frameworks. This could be achieved by examining customer journeys and distribution chains to identify where the customer contact points are, what controls are in place to identify vulnerable customers and whether there is anything more that firms can do to support those with vulnerable characteristics. In response to the final Consumer Duty rules, we are seeing firms explore the use of focus groups including individuals with vulnerable characteristics to test how well these are understood and what additional steps they can take to make communications more accessible.

We have set out below some key questions which firms should be asking themselves when considering whether they are achieving "good" outcomes for customers with characteristics of vulnerability in line with Consumer Duty:

1. Have you taken steps to determine whether your approach to the identification and treatment of vulnerable customers is sufficiently consistent and scaleable across the breadth of the firm's role in the distribution and servicing of products for end retail clients/consumers?
2. What steps have you taken to understand the needs of potentially vulnerable customers within your target market or customers base? (Including whether the product or service offer is "good value")
3. What training is provided to staff dealing with customers? (Including how staff might recognise and respond to the needs of consumers if they were to develop characteristics of vulnerability)?
4. Can you demonstrate that customers' best interests, including those with potentially vulnerable characteristics, are considered in key processes such as product design and communication?
5. What management information is collected to enable you to assess whether consumers with characteristics of vulnerability, or those with protected characteristics, are receiving different outcomes to others?
6. What steps have you taken to assess whether your products are priced differently for vulnerable customers?

Governance and culture

Unsurprisingly, much of the industry debate since the publication of the final rules has focused on the new "Consumer Duty Structure" and what this means for firms in practice.

However the FCA is expecting cultural change too, and the new Consumer Duty also has significant implications for firms' governance arrangements and senior management responsibilities that cannot be ignored.

Firms are already trying to get to grips with the three Cross-cutting Rules. The same is true of the four outcomes, which underpin the new structure, and which deal with some of the more 'micro' level aspects of the new proposals around products and services, price and value, consumer understanding and customer support. All will rightly attract a great deal of attention in the coming months and beyond, as firms gear up for the new requirements.

At a more 'macro' level, the FCA will introduce a new Consumer Principle, which will explicitly require firms to deliver good outcomes for retail customers. How firms define "good outcomes" will set the parameters for much of the more detailed work to be done between now and July 2023. But it's the twin pillars of firms' culture and governance that - as so often is the case - will either allow for a smooth transition or, if not quite right, lead to a slower, bumpier, journey. While neither culture nor governance feature as prominently in the FCA's proposals as some of the more headline-grabbing proposals, both are still very much present. The extent to which firms already have customer-focused cultures, and can truly demonstrate this through good governance, will be key determinants of success.

Cultural change

The FCA is explicit that it wants to set higher standards of care for consumers across the industry, while acknowledging that firms are starting from different points. *"For many firms"*, it says, *"this will require a significant shift in both culture and behaviour, so they consistently focus on consumer outcomes, and put customers in a position where they can make effective decisions"*. The new Consumer Principle is designed to facilitate this; it is intended to drive these changes forward and ensure that firms embed the new Consumer Duty into their culture, policies, and processes.

As per usual, the FCA will be looking to boards to drive the ***"tone from the top"***, on the eminently reasonable presumption that if a firm's senior management doesn't fully buy into the Consumer Principle and set the right expectations from the outset, those who report into them can't be expected to buy-in either.

Most firms will argue that they are already consumer-focused, and that their customers already receive good outcomes. Many will be able to legitimately point to examples of where this is the case. But the wider industry evidence suggests that despite the good intentions and the insistence that customers' interests are always at their heart, few firms get this right all the time, across all facets of their business. Ensuring that customers consistently receive good outcomes, and being able to demonstrate the same, will therefore be key to meeting the cultural challenge laid down by the FCA.

Product governance

In the new world, aiming for the right consumer outcomes and creating the conditions for achieving those outcomes, for example through existing product governance arrangements, will be part of the solution, but they will not be enough. The FCA's approach to product governance goes beyond the current handbook PROD requirements and raises the bar in three key regards:

- The approach is broader - while firms might meet existing product governance requirements and satisfy the products and services outcome, they must also consider other aspects of Consumer Duty, such as whether their consumer support standards meet both the letter and spirit of the new requirements
- firms will need to view things from a different perspective, moving away from the purely forward-looking mindset of "will this product generate the right outcomes?" to that which demands "were good outcomes achieved in practice?", drawing heavily on post-sales experience and data to answer the question
- the updated PROD rules will extend to closed back book products – under the new arrangements firms will be required to have a process to assess, and regularly review, whether any aspect of closed products fail to comply with the cross-cutting obligations, including whether specific groups of customers are disadvantaged in any way.

Corporate governance

Firms' wider corporate governance arrangements will come in for renewed scrutiny too. As one would expect, the FCA has made it clear that the buck stops with the board, and that board directors will be responsible for assessing whether their firm is delivering good outcomes. The FCA sees Consumer Duty and the SM&CR to be mutually supportive.

This is reinforced by the FCA's statement that they "expect the focus on acting to deliver good outcomes to be at the centre of firms' strategy and business objectives, and should be embedded in the same way, and receive the same level of ongoing attention, as financial performance, risk and strategy". This is an interesting development in the FCA's thinking and may be a rude awakening for those firms where financial and commercial matters take up disproportionate time on the board agenda compared to matters of consumer-focus. This will need to change, and, equally importantly, will need to be seen to have changed.

Consumer Duty brings some new prescriptive requirements too, most notably the requirement for 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 at least annually. This assessment should include, for example:

- the results of any monitoring that the firm has undertaken against expected outcomes
- new and emerging risks to good outcomes and how they have been managed and mitigated
- any evidence of groups of consumers, including vulnerable customers, who are not achieving good outcomes, an evaluation of the impact and the root causes, and details of the actions taken to address any shortcomings, and
- whether the firm's future business strategy is consistent with acting to deliver good outcomes under the Consumer Duty.

Crucially, to ensure that the board is taking this seriously, the FCA has stipulated that before signing off the assessment, it should agree the action required to address any issues which are impacting the firm's ability to deliver good outcomes and whether any changes to the firm's future business strategy are required.

New conduct obligations

This focus on future strategy is key too. Among other things, it puts further onus on any non-executive directors, who are already required to exercise a high standard of care, skill, and diligence, to challenge strategy where they consider it is not conducive to the aims of Consumer Duty. Those individuals that are caught by SM&CR will potentially have a new Conduct Rule to think about too, requiring them to "act to deliver good outcomes for retail customers" where their firms' activities fall within scope of Consumer Duty, as well as new obligations mirroring the Cross-cutting Rules 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.

Significantly, in discharging these obligations, firms will need to carefully monitor, on an ongoing basis, a wide range of data sources to ensure the right outcomes are being achieved, identify any areas where this is not the case and take prompt action. Senior management will be expected to explain why they chose a potential course of action over other options and, ultimately, to show that the action they took delivered the right outcomes. Documenting the decision-making process will be key.

So, there is plenty for boards to think about. The culture will need to be genuinely focused on consumer outcomes, and the governance needs to be conducive to both achieving good outcomes and demonstrating that those outcomes are being delivered in practice.

While the rules won't formally come into effect until the Q2 2023, neither cultural change nor embedding new governance arrangements can be achieved overnight; the journey must start now. And for those that don't yet have that sense of urgency, a few words of caution. The FCA has explicitly stated that it expects *"firms to use the implementation period fully and to be able to demonstrate progress when asked"*, and that it will use its supervisory powers *"to review implementation plans and proposed change programmes"*. There is clearly no time to waste.

Pragmatic actions for firms

While the rules won't formally come into effect until July 2023, and are still evolving, there is clearly lots for firms to do. While the new Consumer Duty does not mean starting with a blank slate, because much of what firms have in place already can be repurposed, refocused or recalibrated to align to the new requirements, there will inevitably be new processes and controls to design, test and implement. Moreover, neither the "raising of the bar" the FCA is demanding, nor the cultural changes the FCA would like to engender, can be achieved overnight; the journey must start now.

For those that don't yet have that sense of urgency, a few words of caution. The FCA has explicitly stated that it expects "firms to use the implementation period fully and to be able to demonstrate progress when asked", and that it will use its supervisory powers "to review implementation plans and proposed change programmes". There is clearly no time to waste.

We have set out some of the practical steps that you can be taking now to best position your firm for the new requirements when they come into force:

1. Ensure you can produce a complete picture (including all relevant divisions, business units and third parties) in the distribution chain for all products and services for your end retail clients/consumers
2. Make sure all customer journeys are mapped at a sufficiently granular level to identify the key consumer touchpoints and triggers where the Consumer Duty is most likely to impact
3. Ensure you have a clear picture of how the current control framework deals with third parties, intermediaries, outsourced service providers and joint ventures when considering the duty owed to retail clients/consumers
4. Consider how your firm's strategic and operational taxonomy and lexicon needs to develop to fully reflect this duty and the new terminology it brings. Defining terms such as "good outcomes", "fair value" and "foreseeable harm" clearly and consistently so there is a common understanding across the business will be key
5. Review your approach to the identification and treatment of vulnerable customers to ensure it is consistent and scalable across the firm's role in the distribution and servicing of products for end retail consumers
6. Conduct a thorough gap analysis against the new, higher, standards to identify where and how the current processes will need to change, and identify and prioritise the actions needed to address them
7. Ensure senior managers and material risk takers are clear on their new Consumer Duty obligations and the proposed higher conduct standards for both firms and individuals that will be expected when the new rules come into force
8. Initiate a communications plan to raise awareness, set the tone from the top, and manage staff and third-party expectations in order to frame and facilitate the work that will need to be done across the business to meet the new requirements

How we can help

We are ideally positioned to provide both programme leadership and intelligent, insightful, and practical advice, direction, and assurance to firms. We can support financial services throughout their programme of work to analyse, implement and embed the new Consumer Duty requirements.

More specifically, we can:

- Prepare a detailed analysis of the new requirements and how they impact all areas of your business
- Perform a thorough gap analysis of the requirements of the Four Consumer Outcomes against current frameworks, controls, and processes, together with recommendations on addressing any gaps
- Prepare a plan detailing how and when gaps will be addressed, to ensure firms will meet the FCA's expectations and implementation timescales
- Draft communications plans to raise awareness among staff and support the changes of mindset required to meet FCA expectations
- Design common high-level Business Standards to support customer outcomes that can be rolled out across all business areas and drive consistency of approach
- Refine customer journeys to enable firms to demonstrate compliance with the Consumer Duty
- Leadership via agile programme management to drive forward Customer Duty activities in a highly organised manner, and with pace and urgency
- Advice, challenge, ideas, and direction, driven by our close working relationship with the FCA, learnings from similar work and our broad industry perspective
- Deep subject matter expertise and knowledge transfer on a day-to-day basis across the many areas impacted by Consumer Duty
- Economic analysis to support the identification of key impact areas and measure relevant consumer outcomes
- Ongoing assurance over policy and processes supporting the new Consumer Duty requirements
- Access to a large, scalable pool of skilled resource to assist with 'sleeves rolled up' delivery of the programme
- Senior leadership input into governance of the programme to provide constructive challenge to senior management

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