A new Consumer Duty: further consultation

UK Finance response to CP21/36 from the Financial Conduct Authority

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Introduction and executive summary

The Financial Conduct Authority rightly describes the Consumer Duty as a "fundamental shift" in its approach to regulation, and we have supported the intent behind the Duty since its inception. Done right, it will enable the FCA to identify harmful practices more quickly and intervene before they become entrenched. We welcome changes the FCA has made since its first consultation on the Duty, which have reduced the risks of unintended consequences. Significant issues nonetheless remain, not least with respect to the implementation period, retrospection and interpretation by the Financial Ombudsman Service, with the attendant risk of financial exclusion. We also have significant misgivings about the FCA's cost/benefit analysis. We and members are therefore keen to continue working with the FCA to address these concerns as it finalises its thinking on the shape and content of the Duty. We all want it to succeed.

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support customers and facilitate innovation. We welcome the opportunity to respond to the Financial Conduct Authority's (FCA) further consultation on a new Consumer Duty.[1]

2. We welcome changes the FCA has made since its first consultation on the Duty,[2] particularly dropping the private right of action and the general requirement for firms to take "all reasonable steps." The proposed guidance is also helpful in clarifying some of the FCA's thinking, particularly what it considers to be "good" and "bad" practice. As a consequence, the risks of unintended consequences have been reduced to some extent.

3. Significant issues nonetheless remain, with attendant risks of stifling innovation, differentiation and competition, leading to product restrictions and financial exclusion. These risks will be exacerbated if global firms are disincentivised to allocate capital to their UK operations, reducing investment in the very consumer-facing propositions that the FCA wishes to see.

    - The proposed implementation period is simply too short given the need for firms to review current products, prices, policies, systems, processes and documentation and to amend and supplement them where necessary, all at a time of significant regulatory change and the ongoing Covid-19 pandemic, which continues to preoccupy firms and their customers. The FCA has recognised the need for an iterative approach to implementation by firms and in changing its own processes, but the nine months proposed would not permit this. It needs to be at least two years to allow firms enough time to comply, the FCA to amend the Handbook and any residual risks of financial exclusion to be mitigated, although some members believe there is scope for a phased approach. In any event, the FCA cannot predicate the implementation period on firms starting to implement the Duty before its requirements are finalised and the FCA formally introduces it.

    - The proposed application of the Duty to existing and closed products in firms' back books amounts in practice to retrospection, contrary to the FCA's stated intention. It

[1] https://www.fca.org.uk/publication/consultation/cp21-36.pdf.
[2] https://www.fca.org.uk/publication/consultation/cp21-13.pdf.

is particularly inappropriate to apply the products-and-services and price-and-value outcomes, requiring terms and prices with which consumers agreed before the Duty came into effect to be revisited.

- The risk of the Financial Ombudsman Service (FOS) taking an inconsistent approach remains, exacerbated wherever expectations of firms are not clear. The FCA and the FOS must take the necessary actions to mitigate this risk, and the establishment of an industry forum to provide greater clarity to firms and ensure harmonised interpretation across all participants would be helpful. If the FCA and the FOS are constrained in doing so by their respective statutory roles, HM Treasury (HMT) must intervene to preserve regulatory certainty.

- There seem to be extensive inconsistencies and tensions between the Duty and current Handbook requirements. Regulatory predictability requires the FCA to address these through comprehensive amendments to the Handbook as quickly as possible. Where they persist beyond the Duty being introduced, the FCA must be clear that compliance with the current Handbook will suffice as a matter of principle. This is also true of legislative requirements, particularly in relation to consumer credit, which the FCA should engage with the UK government to address.

- The FCA's intent is for the Duty to be outcomes-based, but its proposed rules focus excessively on inputs. Detailed guidance, informed by industry engagement, is therefore helpful, but the FCA must state clearly in the Handbook that while complying with the guidance will confer a presumption of compliance with the rules, non-compliance will not confer a presumption of breach. Otherwise the level of prescription proposed by the FCA will not be proportionate to firms' different business and operating models and risks reducing the scope for innovation, competitive differentiation and market entry.

- The need to apportion responsibility for delivering good customer outcomes between all firms in a distribution chain (including those without a direct relationship with customers) could have unintended consequences if those at a higher level in the chain look to manage their risk exposure by using unduly restrictive terms of supply.

4. In addition:

- there is a need for further clarity on difficult-to-define concepts, including "good faith," "foreseeable harm" and "value";

- the FCA should also provide greater clarity on the scope of the Duty as regards the firms that will be subject to it, the activities that will covered by it and the retail customers who will benefit from it;

- there is duplication of data-protection rules, as well as tension between the FCA's expectations of compliance with the Equality Act 2010 and customer communications on the one hand and data-protection and e-privacy rules on the other. If unresolved, these tensions will add confusion and complexity to the implementation of the Duty and undermine its intent. It is important that the FCA and the Information Commissioner's Office (ICO) collaborate to ensure firms have certainty about how to meet both regulators' requirements, and the Department for

Digital, Culture, Media and Sport (DCMS) should be consulted if clarifications in the law are ultimately required;

- we seek further explanation of how the price-and-value outcome should be applied in practical terms in order to ensure consistency across firms. This extends to the application of this outcome to products distributed by intermediaries, firms' continued ability to price for risk, the FCA's approach to value assessments, the relationship between platform providers and financial advisors, responsibility for value, consideration of long-term value, estimation of total price and the expected regularity of fair-value assessments; and

- the conflation of vulnerability considerations with diversity, inclusion and socioeconomic factors makes interpreting these concepts challenging and prejudges their proper consideration by the public authorities later in the year. The overlay of vulnerability considerations in several areas may also mean that firms design, price, communicate and support to the requirements of the least able/capable customer in the target market, not the average customer.

5. Finally, we have significant misgivings about the FCA's cost/benefit analysis (CBA). While the FCA seems to have met the minimum requirements currently set out in statute because of the exceptions available to it, we nevertheless regard the CBA as insufficient given it finds costs to firms in the billions of pounds but does not quantify the benefits, fails to assess alternative options for achieving the intended outcome and does not consider the opportunity cost of firms' investment to comply with the Duty. This demonstrates why HMT is right to propose requirements for greater rigour as part of its Future Regulatory Framework (FRF) review.

6. We and members are keen to continue working with the FCA to address these concerns as it finalises its thinking on the shape and content of the Duty.

7. If you have any questions relating to this response, please contact Matthew Conway, Director of Strategic Policy, at matthew.conway@ukfinance.org.uk.

Consultation questions

Q1. Do you have any comments on the proposed scope of the Consumer Duty?

8. The Duty is intended to apply to all products and services offered to retail customers. We welcome the FCA's approach of defining "retail customer" on a sector-by-sector basis by reference to the scope of application of the existing conduct rules for that sector in its Handbook and its acknowledgement that it would be disproportionate to apply the Duty to many larger SMEs. We also note that the newly introduced definition of a "product" will capture both specified investments that are (or are to be) distributed to retail customers and services provided to them in the course of carrying on a regulated or ancillary activity.

9. Several aspects of the Duty's scope, relating to which firms, customers and activities fall within it, require further clarification.

Exemptions and opt-outs

10. Further clarification of the Duty's scope is needed where a sourcebook is subject to an available exemption or opt-out allowing it (or certain aspects of it) to be disapplied to certain customers. We understand that the Duty will not apply in most cases where there is an exemption (e.g. the business-purpose exemption for lending or for services provided to non-banking customers). However, we are unclear whether there are instances where the Duty *may* apply notwithstanding an exemption from the relevant sourcebook. Wherever an exemption or opt-out from a sourcebook applies, the Duty should be automatically disapplied.

Multiple regulated activities

11. Further clarification of the Duty's scope is needed where a sourcebook covers multiple regulated activities and the (retail) customers covered by the Duty differ between these regulated activities. The Duty's scope of application to customers under MCOB is particularly unclear (e.g. it is unclear whether the products-and services and fair-value outcomes are expected to apply to an unregulated lender's third-party administrator). More generally, we would welcome this clarification in all instances where the rules in a particular sourcebook apply to multiple regulated activities.

Amended definitions of "distribute/distributor" and "manufacture/manufacturer"

12. The draft amendments to glossary definitions are not clear. Those for "manufacture" and "manufacturer" have been expanded to include the activities of operating or underwriting a product. Similarly, the definitions of "distribute" and "distributor" have been expanded beyond their existing meaning ("offer, recommend or sell") to include advising on, proposing or otherwise making arrangements with respect to products. Given that terms such as "operating," "underwriting" and "proposing" are not defined in the glossary, what specific additional activities and/or products does the FCA intend to capture through these expanded definitions? For example, the term "underwriting" is used in practice to refer to different activities depending on context, and while it appears that the FCA has insurance underwriting in mind, the definitions as drafted would also capture underwriting by investment banks in the context of capital raising, which we do not think is the FCA's intention.

13. We are concerned that the impact of these changes will be to expand the concepts beyond their scope in retained EU law at a time when the government is undertaking reviews of its status and substance. If this is the FCA's intention, it should clarify and confirm the rationale behind the changes.

Outsourcing and other third-party arrangements

14. The overlay of the Duty is unclear in relation to outsourcing and other third-party arrangements, including servicing/purchasing and arrangements with appointed representatives. The draft non-Handbook guidance makes clear that firms remain responsible for compliance where they outsource activities subject to the Duty. Firms outsourcing to unauthorised third parties will also need to consider the impact of the arrangement on consumer outcomes. We assume that the FCA would not characterise a servicer as a distributor given that the activities of servicers (including customer-communication and -support methods) are ordinarily dictated by the terms of service-level agreements with product manufacturers, leaving little to no discretion for the servicer. However, if servicers and distributors are treated differently, there will be a potential mismatch given that the draft rules provide prescriptive obligations for manufacturers and distributors but say little about servicers.

15. We would like:

- confirmation that the Duty does not expand firms' obligations in relation to outsourcing and other third-party service providers beyond those already provided for by the rules in SYSC 8, the European Banking Authority's guidelines on outsourcing arrangements[3] and existing regulatory expectations in accompanying supervisory statements and finalised guidance;

- recognition of the challenges that acquirers will face given the many unregulated third parties (e.g. referral partners, integrated software vendors, introducers and independent sales organisations) with which acquirers work when providing services to merchants;

- more guidance on the respective roles of manufacturers and master servicers, particularly where the latter are also regulated, in light of paragraph 14 above;

- specific guidance on the application of the Duty to the relationships between principals and appointed representatives;

- guidance on the FCA's expectations regarding the due diligence and oversight of customer outcomes where a firm is making an introduction to a regulated or non-regulated third party for the provision of products or services;

- specific guidance on the application of the Duty where a firm engages with a third party pursuant to a legal or regulatory requirement (e.g. the Bank Referral Scheme[4]) as a consequence of which it may have less (or no) ability to ensure compliance with the Duty by the third party;

[3] https://www.eba.europa.eu/regulation-and-policy/internal-governance/guidelines-on-outsourcing-arrangements.
[4] https://www.gov.uk/government/statistics/bank-referral-scheme-december-2020.

- additional non-Handbook guidance on monitoring by firms with no activities subject to the Duty. This should clarify (e.g. in the overview section of chapter 9) that such firms should monitor changes to their activities so they can take appropriate measures if parts of their business change and come into scope. This could be by way of the firm's board reviewing an annual assessment of its monitoring measures and how its future business strategy may be affected by the Duty; and

- clarification of how the FCA would perceive a servicer that has the regulatory permissions to offer, sell, advise on, propose or provide a product—

  - if the servicer did not use those permissions within scope of the contract of services it offers a firm; or alternatively

  - if a servicer only uses those permissions in a limited capacity for a small part of the services it offers a firm.

Application to overseas firms

16. It would be helpful if the FCA clarified that the Duty only applies to firms' business with UK retail customers subject to requirements in the Handbook.

Payments

17. We would welcome clarification of whether the adoption by acquirers of the Payment Systems Regulator's (PSR) final remedies following its market review into the supply of card-acquiring services will be sufficient for the purposes of complying with relevant aspects of the Duty.[5]

Ancillary activities

18. The Duty's scope requires clarification. We note that the Duty will apply to ancillary activities, and the FCA gives as an example the provision of customer services or other ancillary activities in relation to a deposit. Although the glossary definition of "ancillary activity" has not been changed, we note that draft PRIN 3.2.7 provides that Principle 12 and PRIN 2A rules will apply to a "person" in the distribution chain. The draft non-Handbook guidance also provides at paragraph 2.36 that ancillary activities in scope include those in relation to regulated activities carried on by a different firm in the distribution chain.

19. We would therefore like clarification of the Duty's application to ancillary activities (and activities connected with payments services—e.g. gateway services—or e-money issuance). The FCA should clarify the ancillary activities that it expects to be—and not be—in scope (e.g. advice about running a business provided to a customer of a regulated loan, an invoice-finance facility or unregulated loan provided to a business-current-account customer, and unregulated overdraft or non-financial value-add products or services provided alongside an SME business current account).

[5] https://www.psr.org.uk/our-work/market-reviews/market-review-into-the-supply-of-card-acquiring-services/.

Contracts

20. We would like clarification about whether the Duty's scope excludes all individually negotiated contracts. Indeed, it would be helpful if the FCA clarified the circumstances in which a contract would not be in the Duty's scope.

Exclusions

21. We note that draft PRIN 3.2.8 provides that the Duty carries through existing exclusions in COBS, ICOBS, MCOB, BCOBS, CMCOB, FPCOB, PROD and CONC. The FCA should explicitly cover the treatment of exclusions (e.g. including confirmation that the Duty does not apply at all to regulated mortgage contracts provided to "large business customers" under MCOB) in the finalised guidance to provide clarity for firms. We would also like explicit clarification that the Duty will be subject to the various corporate opt-outs from the Payment Services Regulations 2017 and the Consumer Credit Act 1974/CONC for larger SMEs.

Changes to client categorisation and application to SMEs

22. Given the Duty's application is determined by the specific regulated activity, a firm may not know whether a prospective customer is in scope at the point that it first engages with that customer. We would be grateful for clarification of the FCA's expectations of firms on a change of client categorisation. Examples include:

    - where a microenterprise within the Duty's scope becomes an SME outside its scope;
    - where a high-net-worth (HNW) individual or sophisticated investor no longer meets the relevant thresholds for marketing exemptions under the financial-promotions rules; and
    - where a client has retail categorisation in some asset classes but professional categorisation in others.

23. The FCA should also confirm when this client-categorisation reassessment should be conducted. Firms should not be required to dynamically reassess this throughout the product lifecycle (and, in any event, may not have the data to do so). One option would be to require firms to periodically assess whether an existing customer remains in or out of scope (or obtain customer certification of the same). We note, however, that the scenario of a customer moving in or out of scope after taking a product or service would give rise to similar issues to those raised in respect of back-book and closed products, and our answer to question 3 below also applies here. Firms should, of course, in some circumstances be able to elect to treat a customer as remaining in scope even if that customer goes out of scope (e.g. where a firm's business turnover increases beyond the relevant threshold). In the SME space, for example, turnover and employee numbers can change frequently, dramatically and/or rapidly.

24. With respect to SMEs, we welcome the changes made since the first consultation to apply the Duty on a product-by-product basis to mirror the application of the relevant conduct-of-business rules rather than applying it to all SMEs to the extent that they fall within the regulatory perimeter. Consistent with this, the FCA should make explicit in the finalised rules and guidance that firms are required to consider separately each product or service provided to a customer and to apply the Duty where the product or

service is in scope, not to consider each customer holistically and apply the Duty to all products that the customer holds (notwithstanding that firms may elect to apply the Duty more widely, e.g. where a given customer is in scope for some products or services and out of scope for others).

25. While we consider the sourcebook-by-sourcebook approach to the Duty's application to be logical, not least as a means of ensuring that the Duty does not overreach the regulatory perimeter, the FCA should provide further and detailed guidance on the Duty's application to products and services falling within COBS, given the especially wide range of firms and products subject to that sourcebook. It would also be helpful for the FCA to clarify that although some parts of COBS apply to UK MiFID firms' activities outside the UK, the Duty would only apply to COBS activities with UK retail customers.

26. Following on from this, we note that the existing threshold for a *per se* professional client in COBS 3.5 would mean that firms would need to treat derivatives and other investment business with large SMEs as within the Duty's scope. This is inconsistent with the FCA's agreement in paragraph 3.9 of the consultation that applying the Duty to large SMEs would be disproportionate.

27. Bounce Back Loans should also be excluded from scope given that they are a government lending product with their own scheme rules and CONC 7 still applies.

Third-party guarantors/security providers

28. The draft amendment to PRIN 3.4.3A(2) confirms that where an individual who is not the borrower or hirer provides a guarantee (excluding a legal or equitable mortgage or a pledge) or an indemnity (or both) in relation to a regulated credit agreement, a regulated consumer hire agreement or a P2P agreement, if that individual is not a customer of the firm, they are nonetheless treated as if they were a retail customer for the purposes of the Duty. We assume that the reference to an "individual" is intentional and only captures natural persons and that a corporate guarantor or security provider would not be covered by the Duty, but we would welcome clarification of the Duty's application in these circumstances.

Average retail customer

29. We note that draft PRIN 2A.7.1 and 2A.7.2 allow firms to make assumptions about the needs and characteristics of the average retail customer when identifying a target market or otherwise complying with the Duty. However, draft PRIN 2A.7.2 also provides that individuals within the target market, groups of retail customers holding existing or closed products and particular retail customers may, in fact, have characteristics (including characteristics of vulnerability) different from the characteristics of the average retail customer. Where firms become (or could reasonably be expected to have become) aware of these individuals, groups or particular customers, they are expected to incorporate these different characteristics within the concept of the average retail customer. As such, we consider that the provisions as drafted extend the term "average retail customer" well beyond its natural meaning.

30. The rules should be redrafted to make it clearer that any collective activity (e.g. general communications or product design) can target the average retail customer in

the target market and firms need only take into account individual customers' characteristics in one-to-one interactions. Otherwise it is difficult to think of a scenario in which, for example, a firm could rely on assumptions about the average customer when identifying a target market. On the whole, members would be happy to work with the FCA to explore clarifications prior to the rules being finalised.

Mortgages

31. Consistent with the above, further clarity on the Duty's alignment with MCOB is required. The FCA has not proposed to include a new definition of "retail customer" for the purposes of MCOB. Therefore, in relation to activities that fall within it, the Duty applies to the existing definition of "customer," which does not to take into account MCOB's nuances. For example, in relation to regulated mortgage contracts, MCOB does not apply where the customer is a large business customer (a business that has a group annual turnover of £1 million or more), and firms can tailor MCOB provisions where the regulated mortgage is for a business purpose or the customer is an HNW mortgage customer (a customer with an annual net income of no less than £300,000 or net assets of no less than £3 million or whose obligations are guaranteed by a person with an income or assets of such amount).

High-net-worth regime

32. We note that the Duty highlights the inadequacy of the current general approach to HNW individuals and the need for reform. We also note that HMT's consultation on financial-promotion exemptions for HNW individuals and sophisticated investors proposes changing definitions in a way that will increase the burden on firms to identify which clients may or may not be HNWs/sophisticated.[6]

Q2. Do you have any comments on the proposed application of the Consumer Duty through the distribution chain and on the related draft rules and non-Handbook guidance?

33. The distribution-chain proposals are more problematic than the FCA suggests. Firms will need to review their key supply-chain relationships (upstream and downstream) to identify any gaps in existing information flows, oversight, allocation of roles and responsibilities and/or complaints-handling processes compared to the Duty's requirements. Whereas the FCA does not envisage firms overseeing other firms in the supply chain, we believe the risk in not doing so could result in the FCA and/or the FOS seeking to attribute shared liability to a firm if failures elsewhere in the chain have resulted in poor customer outcomes.

34. The FCA's approach also appears predicated on an assumption that relationships between manufacturers and distributors have longevity and there is an ongoing dialogue regarding the target market and pricing of a product. In practice, distributors such as mortgage brokers seek to identify the most suitable product for their customer, and it is not uncommon for a broker to make a one-off sale of a specialist lender's product where it meets the specialist needs of a customer. The Duty needs to be applied proportionately in such instances to avoid disincentivising manufacturers from

[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1040979/Financial_Promotion_Exemptions_Con.pdf.

providing more specialist products, and it would be helpful if the FCA provided guidance on how it sees this working in practice.

35. The FCA should provide more guidance in the following areas.

End-to-end chain visibility

36. To apportion responsibilities and gain assurances that fair value is being delivered, firms in a chain will potentially need to understand and have information flow on what each other firm in the chain is doing, including fee structure. This raises potential issues of commercial sensitivities and competition law as well as more practical issues in obtaining the required information.

Oversight and due diligence

37. The FCA says that it does not envisage oversight by firms of other firms in the distribution chain. However, in practice, a logical consequence of the FCA expecting firms to get things right first time and avoid foreseeable harm is a need for oversight up and down the chain to ensure apportioned responsibilities are being discharged correctly. Indeed, a certain amount is already required by SYSC 8. We are concerned that, in practice, the FCA may deem harm that has its origins further up the chain was foreseeable to a firm lower down and will seek to hold that second firm partly responsible and *vice versa*.

38. All firms will therefore need to ensure their frameworks for assessing third-party appropriateness are updated to reflect the Duty's requirements, and some may need to undertake more in-depth due diligence (onboarding and ongoing) to better understand whether a particular third party will meet its apportioned responsibility in the chain. In this context, we would welcome more specific and practical guidance on the circumstances (if any) in which a firm at one level in the chain may be deemed accountable for the actions of a firm at another level of the chain and on the actions the FCA will and will not expect a firm to take to help prevent consumer harm resulting from the actions of other firms in its chain.

Dispute risk

39. The apportionment of responsibilities along the chain will increase the scope for disputes between firms in the chain about regulatory and contractual responsibilities. This has not been included in the FCA's analysis. Firms will need to review relevant contractual provisions and assess how they would respond to certain scenarios (e.g. in the event of a regulatory investigation or customer claims) and whether sufficient protection is in place, including in terms of access to relevant documents and information.

Repapering commercial agreements

40. While the FCA's discussion of the impact of the Duty on commercial arrangements in the consultation refers only to the need for co-manufacturer agreements, we consider that to be an oversimplification. Key supply-chain relationships will need to be reviewed to assess whether they are in or out of scope and, if the former, for roles and responsibilities. This repapering exercise could be lengthy and extremely costly.

Complaint and claims management

41. As part of root-cause analysis, a firm handling a complaint will potentially need to assess which other firms in the chain may have borne a portion or all of the responsibility for the poor outcome. More guidance is needed from the FCA on where responsibility will sit for addressing the root cause to ensure future compliance.

All reasonable steps regarding non-UK regulated firms

42. The FCA says that where part of a chain is outside the UK, UK distributors of non-UK products and services will need to take "all reasonable steps" to comply with the products-and-services outcome. We disagree and consider that this proposal effectively amounts to backdoor regulation of the non-UK firm. It would also place a disproportionate burden on the distributor. The requirement should be for distributors to take "reasonable steps" instead.

Wholesale firms

43. We note that where a non-manufacturer firm in the distribution chain can direct and influence the features, terms and operation of a product, that firm will materially influence the product's ability to deliver good outcomes for retail customers regardless of whether it has a direct relationship with end-retail customers and so it will bear a proportion of the responsibility for the respective retail-customer outcomes. The Duty will therefore apply to certain wholesale firms "where a firm's retail market business involves operating in a distribution chain" (draft PRIN 3.2.7).

44. While this is clear on the face of it, we would welcome additional guidance about the extent to which the Duty would apply in practice to payment activities both in general and to payment services provided to non-retail but consumer-facing clients such as corporates, financial institutions, other payment-service providers, large charities and public-sector organisations. Such services include the provision of deposits, commercial cards, services provided to payment intermediaries, payroll services for corporates, indirect-access provision and payment services provided for e-commerce/merchants and utility companies.

45. Draft PRIN 3.2.6 states that Principle 12 and PRIN 2A apply to a firm's retail-market business only. "Retail market business" is defined to include "payment services . . . and activities connected to the provision of payment services . . . of a firm in connection with a product that has been distributed or will be distributed to retail customers." For payment-services firms providing payment services directly to the types of non-retail client set out above, there is no product that will be distributed to retail customers, nor are they "operating in a distribution chain." Section 2.16 of the draft non-Handbook guidance states, "Only firms directly engaged in a retail product or service are subject to the Consumer Duty," but section 2.17 states, "This could include firms in the wholesale market, even if they do not have a direct relationship with the retail customer." We would be grateful for clarification of the position for firms providing payment services to non-retail clients in the scenario described above.

Payments

46. Payments is a highly regulated, network-driven service involving multiple parties (e.g. payment-system operators, scheme managers, technical service providers, customer-

facing merchants and payment-service providers—PSPs), limiting the extent to which a single PSP could influence or control a retail-customer outcome. In addition, the provision of payment services is already governed by the Payment Services Regulations 2017 (PSRs, which include consumer-protection measures), the FCA's Payment Services and Electronic Money—Our Approach[7] and scheme rules such as those in place for transactions processed via Bacs, Faster Payments or the card schemes. We note that, according to PRIN 3.1.8, "The Principles will not apply to the extent that they purport to impose an obligation which is inconsistent with requirements which implemented the Payment Services Directive, the Consumer Credit Directive or the Electronic Money Directive." In the interests of proportionality, we would argue that compliance with the PSRs and the FCA's Approach document should be sufficient.

47. We also seek guidance on the interplay between the PSRs and the so-called "corporate opt-out," which allow firms to disapply certain conduct-of-business provisions.

Q3. Do you have any comments on the proposed application of the Consumer Duty to existing products and services and on the related draft rules and non-Handbook guidance?

Q4. Are there any obstacles that would prevent firms from following our proposed approach to applying the Consumer Duty to existing products and services?

48. We note that the consultation and draft non-Handbook guidance explicitly provide that the Duty has no application to past actions of firms, and actions taken before the Duty comes into force will be subject to the rules that applied at the time, but that the Duty is intended to apply on a forward-looking basis to existing products held by customers, including those no longer offered by a firm (closed-book products). Nonetheless, the draft Handbook text does not contain any express provision that this is the case. It should do, placing an express limit on firms' compliance with the Duty such that it is forward-looking from the end date of the implementation period only, to ensure that the FCA, the FOS and the courts do not overstep the Duty's reach. We suggest including the following wording in PRIN 2A as a transitional provision with indefinite application to achieve this.

This instrument applies to all new products or services, all existing products and all closed products that are no longer for sale or renewed but remain active and used by customers from [date instrument comes into force].

For the avoidance of doubt, this instrument is forward-looking and shall not be applied retrospectively. Actions taken by firms that pre-date [date instrument comes into force] cannot be regarded as a breach of any part of this instrument. Only action or inaction by firms from [date instrument comes into force] going forward can be considered.

49. Even with this forward-looking provision, the proposed application of the Duty to products (including closed-book products) that were entered into by retail customers prior to the Duty coming into force is tantamount to its having retrospective effect. It will require firms to review, during the implementation period, all the products (including closed-book products) they have in the market through the lens of the cross-cutting

[7] https://www.fca.org.uk/publication/finalised-guidance/fca-approach-payment-services-electronic-money-2017.pdf.

rules and outcomes and, where relevant, to take “appropriate action to mitigate the risk of actual or foreseeable harm” to retail customers.

50. This would be a significant, large-scale, exercise for firms. It also risks delivering poor customer outcomes through firms having to take decisions detrimental to customers or having to devote extensive resources to the task, compromising their capacity to pursue the other objectives of the Duty. While retrospective application would be challenging to the achievement of all outcomes, and notwithstanding draft PRIN 2A.4.24, it would be particularly burdensome to apply the products-and-services and price-and-value outcomes retrospectively. For example:

- in markets for longer-term lending (e.g. mortgages), there is likely to be a significant number of products that are closed book and/or entered into more than 10 (sometimes up to 20 or 30) years ago. In addition to the significant scale of the exercise on implementation if such products were within scope of a backward-looking review, it would be inappropriate to assess the product-design process and pricing of a product sold in regulatory, economic and market conditions completely different to those prevailing today. If this approach were applied, it could lead to detrimental outcomes for customers (e.g. if firms concluded because of such a review that they had little choice but to make contractual adjustments or seek to terminate agreements). It could also be detrimental to other stakeholders (e.g. if a back-book review requires a reprice in favour of the customer and reduces returns or crystallises losses for the firm, with potential implications for capital ratios and valuations);

- for some products (e.g. lifetime mortgages/equity release), customers will continue to pay for several years after they receive the benefits;

- the implications for open-ended agreements (e.g. in relation to credit cards) are unclear. While the core proposition of such products will remain similar, individual terms and product names may vary, and firms will need to determine if the whole book is classed as an existing product or if and when a cumulative variation in terms would mean it was deemed new and should be assessed against the full suite of the Duty’s outcomes;

- in theory, the price-and-value outcome would need to be applied to back books on an individual-contract basis because credit risk feeds into price. In practice, it is unrealistic to expect firms to rerun credit-risk analyses in relation to every loan in their book;

- the suggestion that lenders may simply vary contractual terms to align with the Duty fails to address the legal challenges lenders face under the current consumer-credit regime. Variation of a regulated agreement is subject to strict and complex requirements prescribed by statute, failure to comply with which can render the agreement unenforceable. There could also be contractual limits to a firm’s ability to unilaterally vary a contract; and

- Libor cessation has revealed the variation of many regulated credit agreements (particularly fixed-term loans) and some mortgages to be virtually impossible without customer consent.

51. The FCA's proposed approach could also have significantly adverse effects on competition in the market, particularly for the buying and selling of loan portfolios (including secured and unsecured debt), as it would expose potential purchasers to the risk of such backward-looking reviews. This, in turn, would make it harder for firms that have this business model to compete with those that do not. It could also result in inconsistent treatment. For example, it is unclear whether the FCA intends the Duty to apply to closed-book products held by unregulated entities as well as to those held by regulated firms. It would not be appropriate for a regulated servicer to have to review the design and pricing of products serviced for an unregulated lender, just to support and communicate with customers in line with the Duty when servicing them.

52. Some members favour carve-outs from the need to review back books (e.g. for fixed-term products with limited time remaining before termination), possibly subject to further consultation. Some others suggest that all closed fixed-term products should be outside the product-and-service and price-and-value outcomes as the contractual rights are set, enabling closed-book lenders to make changes they consider appropriate while being able to focus on ongoing contractual relationships on a forward-looking basis.

Privacy and data-protection challenges

Compliance with the Equality Act and the UK General Data Protection Regulation

53. In the draft rules and guidance, the FCA expects firms to assess impacts on groups, including those with protected characteristics (notably race and ethnicity) under the Equality Act. These are special-category data under the UK General Data Protection Regulation (GDPR) and can only be collected and processed in very tightly defined situations. Similarly, assessing impacts on vulnerable-customer groups might require the collection of health data, which is also subject to special-category protections under GDPR. This challenge is applicable in relation to several sections of the draft non-Handbook guidance, notably paragraphs 5.17, 6.44, 6.51, 9.11 and 9.25.

54. To collect and process such categories of personal data, firms would need to either:

- collect individual customers' explicit consent (in which case customers would need to opt in and could not be required to agree to the data collection or processing); or

- rely on an argument that the processing is in the substantial public interest.

55. This reflects the sensitivity inherent in special-category data such as health and protected characteristic. Where firms need to meet the Duty's requirements, it is likely that consent will not be appropriate. Broadly, under GDPR, consent to such a use of an individual's personal data cannot be made a prerequisite for providing a particular service to them (see our answer to question 8 below).

56. On the other hand, schedule 1 to the Data Protection Act 2018 sets out strict conditions that must be met to lawfully process special categories of personal data in the substantial public interest. Schedule 1 contains permissions to process special-category data for the purposes of pursuing equality of treatment (paragraph 8) and to protect the economic well-being of individuals at economic risk (paragraph 19). However, these provisions are limited, complex and uncertain in their application, and they bring additional administrative requirements for firms seeking to rely on them. The

provisions lack clarity and are potentially insufficiently wide to permit the data collection and processing seemingly anticipated by the FCA.

57. Without greater clarity, this places firms in a dilemma regarding particular data processing. It is probable that processing that could help support compliance with the Duty would not meet the requirements of schedule 1 of the DPA or would at least (given the relative novelty of GDPR and the lack of a settled body of interpretive case law) introduce material uncertainty and risk. This could translate into a significant financial risk for firms if they are later faced with private claims for damage (including material distress) caused by a breach of GDPR, even if as a result of processing solely to meet the Duty's requirements.

58. Enabling greater collection and processing of special-category data so that firms can improve the fairness of their business practices (specifically in relation to artificial intelligence—AI) was a topic covered in the September 2021 consultation by DCMS on the reform of data-protection law.[8] DCMS has yet to publish its conclusions.

59. The FCA's expectations need to reflect what firms can legally do under data-protection law. It should discuss its detailed requirements with DCMS, the ICO and the Centre for Data Ethics and Innovation (CDEI) to ensure that the UK has a coherent approach that effectively balances privacy and consumer protection. Jointly developed guidance for the sector would significantly reduce the uncertainty faced by firms.

60. If such data collection is ultimately taken forward, this will need to be done with care to avoid customer misunderstanding and maintain trust. Customers will likely expect enhanced transparency of the purposes for which these non-standard data are collected and processed and of the safeguards that firms will implement to ensure they are only used in pursuance of the Duty and not for a broader set of purposes (e.g. demographic profiling or marketing).

61. See our answer to question 11 below in relation to customer communications, direct marketing and the Privacy and Electronic Communications Regulations 2003.

Q5. Do you have any comments on the proposed Consumer Principle and the related draft rules and non-Handbook guidance?

62. We welcome the FCA's proposal to adopt "good outcomes" as the operative term of the Consumer Principle. Requiring firms to achieve good outcomes for their customers is more consistent with the outcomes-oriented philosophy of regulation underpinning the Consumer Duty than the alternative mooted wording requiring firms to act in their customers' "best interests."

[8] See paragraphs 81-93 at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1022315/Data_Reform_Consultation_Document__Accessible_.pdf.

Q6. Do you agree with our proposal to disapply Principles 6 and 7 where the Consumer Duty applies?

Q7. Do you agree with our proposal to retain Handbook and non-Handbook material related to Principles 6 and 7 should remain relevant to firms considering their obligations under the Consumer Duty?

63. We agree with the proposal to disapply Principles 6 and 7 to the extent that the Duty, in particular Principle 12 (the Consumer Principle), applies. As we argued in our response to the FCA's first consultation on the Duty, [9] disapplying regulation superseded by the Duty will avoid firms having to navigate an unnecessarily complicated Handbook in which rules have been superseded by the Duty and therefore have no residual purpose. This is clearly the case in respect of Principles 6 and 7 given the FCA's intention that, "Principle 12 imposes a higher and more exacting standard of conduct in relation to a firm's retail market business relative to what Principles 6 or 7 would have otherwise required."

64. Draft PRIN 3.2.11 states that, "Principle 12 and PRIN 2A have a broader application than Principles 6 and 7, for example it applies to firms in the distribution chain in relation to which the consumer may not be a client." Given the FCA's stated intention for the Duty's scope, the reference to "consumer" should be amended to "retail customer."

65. We agree with the proposal's underlying logic that Handbook and non-Handbook material related to Principles 6 and 7 should remain relevant to firms considering their obligations under the Duty. Given the FCA's intention for the Duty to impose a higher standard of conduct relative to Principles 6 and 7, it is likely that where a firm is not acting in accordance with existing guidance on Principles 6 and 7 and the behaviour would amount to a breach of Principles 6 or 7 in the event that they had continued to apply, the behaviour is likely to amount to a breach of Principle 12.

66. However, preserving references to the superseded Principles in Handbook and non-Handbook material will make it more difficult for firms to interpret such material and to ascertain the regulatory requirements with which they need to comply. This extra difficulty in complying will ultimately result in higher costs for customers. The FCA should therefore revise references in its Handbook and non-Handbook material to Principles 6 and 7 that may be confusing for firms, including:

- finalised guidance on consumer credit and coronavirus (e.g. tailored support guidance[10] and payment-deferral guidance on personal loans[11] and credit cards[12]);
- finalised guidance on mortgages and coronavirus;[13]

[9] https://www.ukfinance.org.uk/system/files/210730%20UK%20Finance%20response%20to%20FCA%20Consumer%20Duty%20consultation.pdf.
[10] https://www.fca.org.uk/publication/finalised-guidance/consumer-credit-coronavirus-tailored-support-guidance.pdf.
[11] https://www.fca.org.uk/publication/finalised-guidance/personal-loans-coronavirus-deferral-guidance.pdf.
[12] https://www.fca.org.uk/publication/finalised-guidance/credit-cards-retail-revolving-credit-coronavirus-payment-deferral-guidance.pdf.
[13] https://www.fca.org.uk/publication/finalised-guidance/mortgages-coronavirus-payment-deferral-guidance.pdf and https://www.fca.org.uk/publication/finalised-guidance/mortgages-coronavirus-tailored-support-guidance-jan-2021.pdf.

- finalised guidance FG18/7 on fairness of variation terms in financial-services consumer contracts under the Consumer Rights Act 2015;[14]

- finalised guidance FG15/4 on social media and customer communications;[15] and

- finalised guidance FG16/7 on regulation 13 (packaged accounts) of the Payment Accounts Regulations 2015.[16]

67. More significantly, there seem to be extensive inconsistencies and tensions between the Duty and current Handbook requirements. Annex 1 sets out the potential instances that we have identified to date. These include requirements in direct conflict (i.e. where the Duty and an existing Handbook requirement prescribe mutually exclusive courses of action) as well as differences in terminology and approach.

68. Where confirmed, these inconsistencies must be addressed through comprehensive amendments to the Handbook, otherwise firms will be in the difficult position of not knowing with which requirements to comply, customers will not have certainty about the regulatory protections from which they should benefit, and the FOS's interpretation may differ from that of the FCA and/or risk being inconsistently applied. It is imperative that the FCA resolve conflicts between the Duty and the Handbook prior to the Duty coming into force.

69. Given the likelihood of inconsistencies remaining or being discovered beyond this point, the FCA should state clearly in Handbook guidance that compliance with current requirements will suffice as a matter of principle where this is the case. This would provide regulatory certainty to firms and customers alike until the FCA makes the necessary amendments.

70. There are also inconsistencies between the Duty and legislative requirements (e.g. the prescriptive provision of information in the Consumer Credit Act hinders consumer understanding, and the Mental Capacity Act 2005 asserts that a person should not to be treated as unable to make a decision merely because he makes an unwise decision), so the FCA should engage with the government as appropriate, as it commits to doing in the consultation. A financial-services bill in the next (2022-23) session of Parliament would be perfectly timed to resolve inconsistencies with the Duty that require primary legislation.

71. Although we have identified none to date, we suggest that the FCA consult with the PSR to ensure that there are no inconsistencies between the Duty and its existing and prospective requirements.

Q8. Do you have any comments on our proposed cross-cutting rules and the related draft rules and non-Handbook guidance?

72. We welcome removal of the requirement for firms to take "all reasonable steps" to avoid foreseeable harm and enable retail customers to pursue their financial objectives, as well as the clarifications that the cross-cutting rules will not create a fiduciary

[14] https://www.fca.org.uk/publication/finalised-guidance/fg18-07.pdf.
[15] https://www.fca.org.uk/publication/finalised-guidance/fg15-04.pdf.
[16] https://www.fca.org.uk/publication/finalised-guidance/fg16-7.pdf.

relationship or impose an open-ended obligation on firms to protect customers from all poor outcomes.

73. We would welcome further clarity on the concepts of “good faith,” “foreseeable harm,” “support,” “achieve financial objectives” and “value.” Such terms are inherently difficult to define, and uncertainty about their meaning will exacerbate the risks attendant on the FOS’s interpretation of the Duty (as set out in our answer to question 15 below).

74. We are concerned that the cross-cutting rule requiring firms to avoid foreseeable harm to retail customers could require a firm to act to prevent harm that, while foreseeable, is not directly caused by the firm or within its control (i.e. harm that is unrelated to the design or pricing of the product or service or the firm’s customer-support or communications activity). We are also concerned that if firms are expected to take decisions about how customers should use products, this will cause harm rather than prevent it as firms are unlikely to have a complete and accurate understanding of customers’ overall financial position and objectives in the short and medium terms.

75. The FCA should clarify that its intention is not to require firms to:

- avoid foreseeable harm that is not within their control. Examples include a customer falling victim to an authorised-push-payment (APP) scam and insisting on making payments even after warnings from the firm, or the firm not preventing customers spending excessively on alcohol or gambling. Other examples would be where a firm offers a 10-year fixed rate mortgage product to a couple who subsequently separate, resulting in an early repayment charge, or lends to a consumer employed in the fossil-fuel industry whose employment may be at greater risk in the future. Foreseeable harm outside the firm’s control may also occur through the actions of third parties in the distribution chain (e.g. the collapse of a third party to which a firm has referred historically); or

- make assumptions about the best way for customers to use products and override their decisions. Examples include intervening to prevent a customer going into overdraft where they have funds in other accounts, rejecting a customer’s application for a loan in circumstances where they have adequate savings to use instead or giving notice to terminate a credit-card product with a monthly fee if the customer has not used the card for a period of time. In each of these examples, it might not be immediately clear to the firm why the customer wants to use credit (or have access to credit) when they have positive balances elsewhere, but the customer may be planning to use their savings to satisfy another financial objective that is unknown to a firm, organising their spending in a particular way to align with their lives or wanting to ensure that credit is available to build up their credit rating or as a safety net in the event that they need to make an unexpected purchase.

76. Moreover, “avoiding” foreseeable harm implies no resultant harm from action or inaction. It effectively means that firms should not include or exercise variation rights in contracts or adjust products to reflect developments (e.g. in competition, technology, markets, operating models, legislation and regulation) in the environment in which they operate if any harm results to any customer in the target market. This highlights uncertainty in the FCA’s proposals about whether it wants firms to mitigate or truly avoid foreseeable harm.

77. We would also be grateful for clarification of the following.

- Guidance on the cross-cutting rule on customers' financial objectives states that firms providing an execution-only or non-advised service can assume their customers' objective to be the enjoyment and use of it. The FCA should confirm that, in such a scenario (and, indeed, as a general rule), firms are not required to make any additional enquiries to satisfy themselves further as to any intention the customer has for the use of the product or service (e.g. to purchase a car with loan proceeds). When a firm is evaluating or monitoring a product or service, there should be an inherent assumption that the customer chose to buy the product and firms should not be required to conduct suitability assessments across all products over their lifecycle.

- How does the FCA intend the concept of reasonableness that underpins the Duty to operate alongside its expectations for reasonable steps from the perspective of the Senior Managers and Certification Regime (SM&CR)?

- The FCA's requirements and expectations should apply on a product basis rather than across multiple products that are subject to the Duty. It is neither appropriate nor workable for firms to apply the Duty across multiple products because:

    - without explicitly providing financial advice, it is unclear how good outcomes across multiple products could be established. For example, a customer with substantial savings in an account with a firm may or may not be better off making a lump-sum payment to reduce the balance of a mortgage they have with the same firm, but a firm would need to provide advice in order to determine this;

    - if a firm were expected to consider a customer's financial situation across multiple products held with it, this would cut across the FCA's statement that a firm providing an execution-only or non-advised service can assume their customer's objective is the enjoyment and use of the product; and

    - unless a customer takes out every financial service or product with the same firm, a firm will never have an accurate view of a customer's overall financial position, so there is a risk that its actions will not be helpful.

- If a firm takes an action in relation to a mass-market product and it adversely affects a minority of the target market but is neutral or positive for the majority, would that breach the Duty?

- Does demonstrating and evidencing a reasonable belief that customers understood and accepted risks inherent in a product, particularly in the context of online or execution-only sales, require firms to introduce "positive friction" into the journey to ensure that customers do not click too quickly to accept that they have read, understood and accepted the terms and risks of the product? Is the test applied by reference to the average customer or the individual customer? There is a risk that firms will not provide even basic products to customers where there is a concern that they will not pass this reasonable-belief test.

78. We note that the FCA has provided examples of behaviours that would or would not conform with its expectations under the cross-cutting rules. However, these examples are largely generic. We would find it helpful if the FCA supplied further guidance

focused on specific products and services. Coupled with examples of behaviour that the FCA would consider unreasonable, this would provide firms with certainty about required standards so that they can revise their policies, processes and communications.

Privacy and data-protection challenges

Unreasonable data collection

79. Draft PRIN 2A.4.13 and 2A.6.3 suggest that providing personal data and granting permission to access customers' personal data are examples of a non-financial cost. Paragraph 2A.6.3 highlights that this could include "unreasonably" requiring personal-data provision or access. These paragraphs are supported by paragraphs 6.31 and 8.17 of the draft non-Handbook guidance. The FCA needs to clarify how these paragraphs interact with GDPR obligations, in close discussion with the ICO.

80. We infer from the draft rules and guidance that the FCA's concern is that firms might unfairly "force" customers to consent to the collection and processing of their personal information as a condition of service through "take-it-or-leave-it" terms and conditions. This risk is already strictly governed by articles 6 and 7 of GDPR. To collect and process personal data, firms must *inter alia* satisfy the conditions of a legal basis.[17] The most pertinent of these to the FCA's concern are as follows.

- **The processing is necessary to enter into a contract with the individual or to perform a contract with the individual (article 6(1)(b)).** ICO guidance makes clear that this is limited to situations in which the service sought by the individual cannot be provided without the personal data, such as processing account and card details to execute a payment. It would not cover a contractual requirement on the individual to agree to data collection or processing desired by the firm for some other reason (e.g. marketing or onward sale to a third party).

- **The individual has consented to the collection or processing of the personal data (articles 6(1)(a) and 7).** This legal basis only applies where the consent is "freely given," not (in general terms) when the individual is "forced" to consent as a condition of access to a service or is otherwise manipulated. Consent is typically applicable to "optional extras" on top of core services (e.g. receiving marketing). Individuals are also legally able to withdraw consent and effectively stop processing of personal data pursuant to that consent at any time.

- **The processing or collection is necessary for the purposes of the legitimate interests of the firm (article 6(1)(f)).** This is the only legal basis that allows firms to collect and process personal data for their own business purposes beyond the minimum needed to provide the service sought by the customer. It is the most flexible legal basis and the only one that could, in theory, cover the kind of data-collection and -processing risks that the FCA appears to be targeting. However, this legal basis cannot be relied on by a firm when its interests "are overridden by the interests or fundamental rights and freedoms of the data subject" (article 6(1)(f)). There is detailed ICO guidance on legitimate-interest assessments. Individuals also

[17] See https://ico.org.uk/for-organisations/guide-to-data-protection/guide-to-the-general-data-protection-regulation-gdpr/lawful-basis-for-processing/.

have an established, qualified right to object to a firm's processing of their personal data and, ultimately, the ICO if a firm does not have compelling legitimate grounds to continue processing them. As such, the risk that the FCA appears to wish to address already has a well established and robust set of controls around it, enforced by the ICO.[18]

81. GDPR therefore already prevents firms from imposing take-it-or-leave-it contractual obligations on customers to allow collection and processing of personal data, with comprehensive controls to prevent unfair use of such data for business purposes. We doubt that there are situations in which personal-data processing could be permitted by a GDPR legal basis but considered "unreasonable" by the FCA. As such, the FCA's proposals in this respect seem unnecessary and risk adding complexity without improving consumer protection. As they seem highly duplicative of GDPR itself, these elements of the draft rules should simply be removed unless the FCA can articulate the interaction with GDPR and set out why this alone is insufficient.

82. In any event, the FCA should discuss this issue with the ICO to ensure that the UK retains a coherent and non-duplicative regulatory framework.

Artificial-intelligence bias

83. Paragraph 4.14 of the draft non-Handbook guidance gives the following example of "not acting in good faith":

Using algorithms, including machine learning or artificial intelligence, within products or services in ways that could lead to consumer harm. This might apply where algorithms embed or amplify bias and lead to outcomes that are systematically worse for some groups of customers, unless differences in outcome can be justified objectively.

84. While we agree with the sentiment, the issue of "AI bias" and "AI fairness" is highly complex, with DCMS, the ICO and the Equalities and Human Rights Commission all working on policy and guidance. The FCA's Innovate Team has spent over a year working on AI issues with its AI Public Private Forum, with a report due out soon. This raises several issues.

- How does the FCA's work on the Duty align with that of its Innovate Team?
- Given the complexities involved in the issue of AI fairness and the fact that guidance is still forthcoming, adding this to the Duty guidance is premature.
- In its current formulation, this provision seems to overlap with the requirement for firms to check for unjustified differences in group outcomes. These obligations seem duplicative as "AI bias" is presumably an application of Equality Act rules against discrimination to the use of algorithms and models. Fundamentally, if these two elements of the Duty are retained, more detail is required to explain what the FCA in fact expects firms to do. Further, as highlighted in our response to question 4 above, it is currently unclear at best to what extent firms can collect special-category data (e.g. on race and ethnicity) to monitor for AI bias and fairness, with DCMS currently considering potential legislative changes to address this issue.

[18] See https://ico.org.uk/for-organisations/guide-to-data-protection/guide-to-the-general-data-protection-regulation-gdpr/legitimate-interests/.

- Moreover, this section of the draft non-Handbook guidance relates to firms acting in bad faith, not failing to deliver good outcomes for customers. The three other examples relate to intentionally manipulative acts by firms, while the AI bullet relates to potentially accidental occurrences of which the firm might not be aware. If such a provision is retained in the final guidance as an example of acting in bad faith, it should be reformulated to relate to firms knowingly using algorithms that exhibit signs of unfair bias, without suitable mitigations in place, or failing to adequately check for signs of unfair bias. A firm that has suitable governance in place and performs appropriate monitoring of algorithm performance cannot be acting in bad faith if, in due course, previously undetected unfair biases are discovered.

85. The FCA should therefore remove this component of the draft non-Handbook guidance until wider AI-regulation policy is further advanced. Failing that, the guidance should be reframed to relate more closely to the question of acting in bad faith. In either event, the FCA should discuss this issue not only with its Innovate Team but also with the ICO, the Office for AI, CDEI and DCMS.

Q9. Do you have any comments on our proposed requirements under the products-and-services outcome and the related draft rules and non-Handbook guidance?

86. **Financial exclusion.** In our response to the first consultation, we expressed significant concerns about the risks of unintended consequences posed by the Duty, including decreased product choice and potentially financial exclusion because of firms becoming increasingly risk averse. These concerns have been allayed to an extent by the revised proposals in this second consultation, in particular the removal of the obligation for firms to take "all reasonable steps," changes to the price-and-value outcome and clarifications about foreseeable harm, as well as by the FCA's proposed non-Handbook guidance. Members note the FCA's view that it consequently does not expect the Duty to restrict access to products and services. We believe that the risk of financial exclusion nonetheless remains. For example, firms may be deterred from providing more specialist products if price-and-value outcomes are assessed against those for mass-market products. Impacts may also be felt across the consumer spectrum, from customers with characteristics of vulnerability to HNW customers. This is exacerbated by the potential for divergent interpretation of the Duty's requirements by the FOS.

87. **Target market.** The draft rules and guidance generally lack clarity with respect to mass-market products (or other customers who fall short of the mass market but represent a significant market proportion, such as the self-employed). The guidance suggests that identification of the target market should be relatively straightforward, but the requirements to ensure that the design of (and distribution strategy for) the product or service meets (or, following review, continues to meet) the needs, characteristics and objectives of consumers in that market must be read alongside and interplay with other rules and guidance relating to the treatment of both average customers and customers with characteristics of vulnerability. This complexity can best be addressed by specific guidance focused on reasonable actions that firms could take to support delivery of the products-and-services outcome with respect to mass-market products.

88. **Product review.** The draft rules (e.g. PRIN 2A.3.8 and PRIN 2A.3.24) impose parallel obligations on manufacturers and distributors to take action following their respective

reviews of a product to mitigate any further harm to a customer. However, it will be difficult to reconcile these two competing obligations if the manufacturer and distributor reach different conclusions on the action to be taken, or to see how both could meet their obligations under PRIN 2A.3 without terminating the agreement. As drafted, the obligation is for each party individually first to perform the review and then to inform each other person in the distribution chain. The draft rules would benefit from further guidance on how manufacturers and distributors should work together to mitigate harm before remedial action must be taken.

89. **Requirement to enter into a written agreement.** Paragraph 5.5 of the draft non-Handbook guidance states that where firms collaborate to design a product, "they must have a written agreement outlining their respective roles and responsibilities to comply with the rules in this section." Such a requirement is a significant burden that will reduce collaboration and therefore hinder innovation. It is also difficult to see what benefits it will bring given that firms manufacturing the product will be in scope of the Duty and therefore required to comply. It should therefore be removed.

90. More generally, there is a risk that the lack of clear direction in the draft guidance will lead to inconsistencies in how firms design their approach to meeting this outcome. The guidance should include more detailed examples across a range of products and services.

91. We raise concerns about the requirements for back-book reviews in our answer to questions 3 and 4 above. The FCA should provide examples of where communications (rather than, for example, changes to product terms and conditions) would suffice to address identified issues following a product review.

Q10. Do you have any comments on our proposed requirements under the price-and-value outcome and the related draft rules and non-Handbook guidance?

92. We welcome the FCA's clarification that it does not intend the price-and-value outcome to enable the setting of price caps or other forms of pricing interventions. We remain of the view that the FCA's existing competition powers are a more suitable tool for addressing high prices that result from ineffective competition. The draft non-Handbook guidance on the outcome rightly underlines this point, and the relevant Handbook changes should also contain guidance to this effect.

93. Members nonetheless remain uncertain about what the FCA wants firms to achieve through this outcome, how they should put it into practice and how they could demonstrate compliance. The FCA's proposed guidance is helpful but complex, and firms recall the difficulties associated with implementing PROD. Without further clarification, there is a risk of inconsistent interpretation of the outcome not only between firms but also between the FCA and the FOS. Inconsistency between firms will lead to inconsistent outcomes for customers; inconsistency between the FCA and the FOS is likely to foster risk aversion among firms, including the withdrawal of products and services and a reluctance to innovate. (Our general concern about the role of the FOS in respect of the Duty is set out in our answer to question 15 below.) We would welcome clarity in the following areas.

The application of this outcome to products distributed by intermediaries

94. Under the Duty, distributors will be responsible for delivering price-and-value outcomes in relation to any product they distribute. Therefore, for example, a mortgage broker will ask every lender whose products it sells to share their assessments of the fair value of those products, but lenders will not want to do this as it will be commercially confidential. We would therefore welcome guidance on the responsibilities of both manufacturers and distributors in situations where the price-and-value outcome appears to require the sharing of commercially sensitive information.

Firms' continued ability to price for risk

95. The price that firms set for their products reflects the costs to them of taking various associated risks, including credit and conduct risk. It is unclear the extent to which pricing decisions will be considered acceptable where a firms' reflection of credit risk in its pricing is not continuous (e.g. charging a higher interest rate for a customer with arrears in the last 11 months in comparison to a customer with the same arrears 12 months ago, or differential interest rates for customers depending on whether they will be 69 or 70 at the end of the term).

The FCA's approach to value assessments

96. Paragraph 6.12 of the draft non-Handbook guidance sets out a range of factors that the FCA "may" consider when looking at firms' value assessments. Value is highly subjective to individuals, such that the value two or more customers glean from the same product may differ significantly. (For example, not all customers will derive the same value from a product including the option of in-branch banking.) To overcome this subjectivity, the guidance should be less equivocal and set out factors the FCA "will" consider.

97. In addition:

- the reference to "market rates and charges for comparable products and services" should be removed because it is not clear what is considered a comparable product or service and a firm could charge a lower rate or price because it is loss-leading or has a different funding model (e.g. wholesale market funding rather than customer deposits) rather than indicating that another firm's offering does not represent fair value; and

- the FCA should provide more guidance on the "non-financial costs" that it requires manufacturers to consider when performing a value assessment under draft PRIN 2A.4.7 and be clear that there is no expectation they should be quantified.

98. The draft non-Handbook guidance is helpful in confirming that the FCA will not focus on margins *per se* but rather on the more holistic value equation and making sure that there are no failures to observe the three other outcomes that could skew the equation against customers in practice. The guidance understandably lists manufacturing and distribution costs as one factor to take into account in the value assessment, but it would be helpful if the FCA could clarify that it does not expect firms to engage in onerous exercises to build fully loaded cost stacks where this information (e.g. relating to the allocation of overheads) is not readily available or used for regular business

purposes. The FCA should also confirm that it does not expect the Duty to require a shift to predominantly cost-plus pricing models.

The relationship between platform providers and financial advisors

99. The example after paragraph 6.34 of the draft non-Handbook guidance states that, in relation to an investment product, platform providers and financial advisors should consider the overall proposition, including the charges for the product, when setting their own charges. Given they do not set the product charges, this part of the guidance causes issues. What should they do if they are concerned about the value of the overall package? The FCA should either remove this provision or confirm what the platform provider should do as these parties do not have the ability to change the product costs.

Responsibility for value

100. Paragraph 6.34 of the draft non-Handbook guidance states that all firms are responsible for the value they control but goes on to suggest that the firm at the end of a distribution chain has responsibility to ensure the customer does not receive poor value. We question how a distributor (other than one that is tied to a single product provider) can have this level of responsibility over a product that it did not design and for which it does not set ongoing costs. It should be sufficient for a non-tied distributor to have selected the most appropriate product in the market for the customer. In the case of tied distributors, we would expect a distributor not to recommend the tied product if it was not suitable for a customer, whether due to the value it offered or because it fell short of the expectations for any of the other outcomes.

Consideration of long-term value

101. The expectation that a product provides fair value for a "reasonably foreseeable period" is problematic in the case of long-term products such as mortgages whose price is contractually set at the point of sale but whose perceived value over the life of the product (which could be up to 40 years) will depend on economic conditions (not least the Bank of England's policy interest rate) that may be volatile and cannot be accurately predicted. Clarity is therefore needed that, in the case of such long-term products, the fairness of the value of the product can be assessed over a shorter and more predictable period than the full term of the product.

Estimation of total price

102. We would welcome clarity of how firms will be expected to assess the total cost of a product to a customer where this will heavily depend on the customer's use of it. For example, should firms assess the value of the highest possible price (however unlikely) that a customer may have to pay in the event of a worst-case scenario (i.e. the highest charges that could be incurred) or instead assess the cost based on how an average customer is likely to interact with the product?

The expected regularity of fair-value assessments

103. We would welcome clarity of whether there will be clear "trigger points" for when a fair-value assessment of an existing product should be undertaken after the initial assessment has been completed. The draft Handbook guidance suggests that

"indicators of harm" and "relevant external factors" could influence the timing, which may indicate that a fixed-intervals approach is not necessarily appropriate. It would be useful if the FCA could expressly state that these include customer complaints or increases in levels of customer attrition, for example.

Impact on free-if-in-credit banking

104. The standard approach to bank-account provision in the UK is a free-if-in-credit model. The FCA should carefully consider whether any new rules or guidance under the Duty could affect this as there would be wide-ranging and significant consequences, including for financial inclusion and not least for customers in lower income brackets and/or vulnerable circumstances.

Q11. Do you have any comments on our proposed requirements under the consumer-understanding outcome and the related draft rules and non-Handbook guidance?

105. Members continually strive to provide their customers with accessible, understandable information to facilitate effective, timely and well-informed decisions, and we support the similar intention behind this outcome.

106. The draft guidance states that compliance with this outcome does not require firms to "tailor all communications to meet the needs of each individual consumer" but rather to satisfy themselves that their communications are "likely to be understood by the average customer intended to receive the communication." We welcome this as more proportionate than requiring firms to ensure all consumers' full understanding. However, we are concerned that this approach is undermined by the proposed PRIN 2A.7.2 (2) and (3) which require the "average" of the target market to be refined down to the average of identified subsets within the customer population and then further refined to take account of individual customers' particular characteristics. These rules should be amended or removed to ensure consistency with the FCA's stated objective.

107. Actively testing consumers' understanding of a firm's communications may introduce friction into the customer journey, particularly where it requires action on the part of consumers. Some are likely to consider such friction as unhelpful (or even as sludge) and a hindrance to their enjoyment of the product or service. The FCA's guidance should recognise this trade-off and the difficulty for (particularly smaller) firms of striking the correct balance.

108. For this reason, we are concerned by the requirement in draft rule 2A.5.7, which states that, "When a firm is interacting directly with a retail customer on a one-to-one basis . . . the firm should . . . check the retail customer understands the information, particularly if the information is reasonably regarded as key information, such as where it prompts that retail customer to make a decision." Members are concerned that compliance with the rule as currently drafted sets an unrealistically high threshold for compliance because it requires firms to "check" that a customer understands information. The only way to do this is to quiz customers extensively (e.g. by asking them about the information provided at each point during a call or when engaging online). The FCA should amend this requirement to allow greater flexibility in how firms manage direct interactions with their customers to avoid unnecessary friction. One alternative would be for 2A.5.7 to require firms to "take reasonable steps to ensure the retail customer understands . . .". Another option would be to issue further guidance making explicit

that firms will not be required to extensively question a customer to ensure they have understood the information provided to them on a one-to-one basis.

109. Achieving this outcome will be hindered by the volume of prescribed information that firms are already required to provide to customers (e.g. by the Consumer Credit Act or the European Standard Information Sheet—ESIS—for mortgages). The technical style of much of this prescribed information does not support ease of understanding and serves to counteract the efforts that firms make with their other communications. The FCA should consider the issue of consumer understanding holistically and take steps to address any prescribed communications that are no longer fit for purpose. The introduction of the Duty also reinforces the case (recently made by the Woolard Review into change and innovation in the unsecured credit market[19]) for reforming the Consumer Credit Act, an anachronistic piece of legislation whose prescriptive nature puts it at odds with outcomes-based approaches to regulation.

110. We would welcome clarity on the requirements in relation to testing of customer communications. PRIN 2A.5.8 states a clear requirement for testing ("A firm must test communications . . ."), but this appears inconsistent with PRIN 2A.5.10, which sets out factors for determining whether testing is appropriate. (Since the latter is guidance, we assume it is the rule that firms will have to follow.) How the testing requirement should be interpreted in the case of prescribed text for specific customer communications (e.g. an ESIS) is unclear, and clarification is needed of the expectations of firms where consumer testing demonstrates that customers in the firm's target market do not understand or are confused by the prescribed text.

111. Our members believe that the examples of good practice in the draft non-Handbook guidance could more clearly illustrate the standard required by the Duty. Firms will assume that examples of poor practice are unacceptable, but it is less obvious whether the good-practice examples illustrate the minimum necessary standard or a level that exceeds this. More generally, the guidance should be updated to recognise the inherent tensions between several of the objectives for firms' communications. For instance, in ensuring their communications are fully accurate, firms are likely to have to compromise on simplicity.

112. While we recognise that a degree of supply-side regulation of consumer communications is warranted to overcome information asymmetries, this should not be at the expense of broader public-sector-led efforts to improve the general public's financial capabilities. Indeed, it is likely that the benefits arising from firms' compliance with this outcome will not be fully realised without such improvements. The Money and Pensions Services (MaPS) may have a useful role to play in this regard given its statutory objective to develop and coordinate a national strategy to improve people's financial capabilities. We therefore recommend that the FCA explore with MaPS what role the latter could play.

[19] https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf.

Privacy and data-protection challenges

Electronic-marketing rules

113. The FCA's expectations of firms to actively communicate with customers about products and services need to align with what firms are permitted to do under data-protection law, including the Privacy and Electronic Communications Regulations 2003 (PECR), and related ICO guidance. We note that there is some discussion of relevant non-FCA regulation in paragraph 7.7 of the draft non-Handbook guidance. We are concerned that "direct marketing" was interpreted broadly by the ICO in its draft direct-marketing code, and communications sent in furtherance of the consumer-understanding outcome may constitute this. Consequently, communications could not be sent to consumers via electronic means (e.g. email or text messages) without consumers' express consent, and communications could not be sent by any means (e.g. including by post) where consumers have previously objected to receiving direct marketing. While it is right that consumers should have the absolute right to object to receiving direct marketing, these consumer-understanding communications should be distinguished from other types of marketing communication (e.g. promotional offers and discounts). If not, the aims of the consumer-understanding outcome may not be realised for a significant portion of consumers.

114. This issue might need to be resolved by the ICO rather than the FCA, so the FCA should discuss it with the ICO to ensure alignment. The FCA might also wish to feed into DCMS's work on reforms to the UK's data-protection laws.

115. Furthermore, the FCA expects firms to test communications (where appropriate) to ensure that they meet the requirements of the consumer-understanding outcome. Email is a preferred channel for communicating with consumers, but it is currently difficult for firms to test engagement with email communications and comply with the restrictions on the use of cookies and "similar technologies" under PECR. An effective method for testing email communications is to use technologies like tracking pixels and plug-ins to collect information (e.g. whether and when an email is opened), but, strictly, PECR requires firms to obtain consumers' express consent to their use. If firms can only use these technologies where consumers have expressly consented, it means that testing can only be conducted on a portion of emails and may not provide accurate and reliable information due to statistically insignificant sample sizes or potential confounding factors if a particular segment of consumers is more likely to consent to such technologies than other segments.

116. Similarly, to segment and tailor communications (e.g. so the length of emails is suitable to the device on which they are likely to be read), firms would need to collect device-level analytical data about consumers over time. This would be likely to conflict with PECR requirements not to access data stored on a device (terminal equipment) without prior consent.

117. We note that DCMS's consultation on the reform of data-protection law proposes to permit organisations to make greater use of analytics cookies and similar technologies without end users' consent. If accepted, this would permit firms to test email communications more effectively and meet the requirements of the consumer-understanding outcome while complying with other data-protection obligations. The FCA should discuss this issue with DCMS.

Q12. Do you have any comments on our proposed requirements under the consumer-support outcome and the related draft rules and non-Handbook guidance?

118. We note that the stated aim of the rules on the consumer-support outcome is to set an appropriate minimum level of acceptable consumer support that all firms must provide, regardless of their size, resources or business model. While the FCA notes that firms are "free to compete by going further," we are concerned that the requirements will reduce the scope for genuine competitive differentiation based on different but nonetheless compliant levels of customer service.

119. We also wonder how this outcome will apply to firms with different business and operating models more broadly. Those with digital platforms will provide a different service to traditional high-street banking options, which may be reflected in prices and fees. While we assume the FCA is looking to ensure that customer support is always effective rather than necessarily the same, the guidance should expressly acknowledge that ease of complying with this outcome will vary depending on channel and product range.

120. We see inconsistencies in the guidance, with suggestions that the rules do not require firms to provide support to consumers via multiple channels followed by statements that "where possible, firms should offer multiple channels of communication, so consumers, in particular those in vulnerable circumstances, have a choice." The FCA should also make clear that it is enough for firms to introduce reasonable alternative measures to support vulnerable customers and they are not always expected to communicate using the customer's preferred communication method (assuming this is permitted by regulation). It would be disproportionately costly and inefficient to suggest that firms should be able to send every message to customers using every method of communication.

121. Specifically, we suggest that the FCA remove the example about a customer who was unable to read large print and did not know Braille but requested communications to be sent by email. This suggests that the FCA expects firms not only to consider vulnerability but also to communicate with customers using the customer's preferred method of communication even though the firm may not be able to support this. The firm in this example has clearly made good efforts to support vulnerable customers by offering to send communications in large print and Braille. In addition, this example contradicts the second bullet of paragraph 7.54 in the draft non-Handbook guidance, which states that the rules do not require firms to communicate via a particular communication channel. If the FCA does not remove this bullet, we suggest amending the example to make clear that if the firm was not set up to provide the communication via email per the customer's original request, it should offer an alternative solution that it can support (e.g. a telephone conversation).

122. Paragraph 8.5 of the draft non-Handbook guidance lacks clarity and appears to add further requirements to the consumer-understanding outcome. It states that, "Under our consumer understanding outcome firms should support consumers by communicating with them at relevant points where there is an opportunity for them to act in in their interests or pursue their financial objectives (e.g. by switching product)." It is not clear what the FCA has in mind here, and this potentially places a disproportionately high burden on firms in respect of compliance. To support customers by communicating with them when the firm feels it could be acting in their

interests, firms would need to keep track of individual customer circumstances and to have knowledge of other products a customer has or has not taken out and the customer's plans. It is not clear to what extent the FCA expects firms to rely on data that they can obtain from other products, connected firms or publicly available sources to determine what would be an opportunity for the customer. The current wording of this paragraph also potentially strays into requiring firms to provide advice, which we do not believe is the FCA's intention. Given that chapter 8 concerns customer support and paragraph 8.5 focuses on customer understanding, we suggest removing it.

123. We would welcome examples in the guidance that further demonstrate the boundary between providing helpful consumer support and providing advice.

124. We welcome the example provided by the FCA of good practice in the event of a delay caused by an unexpected surge in demand. This highlights that website and social-media communications are acceptable means of keeping customers informed in such a scenario.

125. We note the FCA's definition of "sludge practice" in the first consultation and that unreasonable barriers may involve friction within the definition of sludge practice or could stem from other issues such as poor website design. What is missing from the FCA's guidance is the extent to which these two concepts are interchangeable. Members would benefit from guidance on "good friction" so they do not find themselves penalised when attempting to help customers. For example, guidance could provide examples of friction that the FCA views as beneficial and clarify issues such as:

- the point at which customer communication turns into overcommunication (and the consequent risk of the customer disengaging);
- whether offering a digital-only channel is reasonable under the customer-support outcome; and
- whether monitoring the time customers take to read terms and conditions and prompting them to go back if this is insufficient is a reasonable barrier.

Q13. Do you think the draft rules and related non-Handbook guidance do enough to ensure firms consider the diverse needs of consumers?

126. The FCA's finalised guidance FG21/1 on the fair treatment of vulnerable customers (the Vulnerability Guidance) is intended to level up treatment of such customers to the same standard as non-vulnerable customers.[20] We note that it remains relevant and is to operate at the raised level that the FCA intends with the introduction of the Duty. However, references in it to meeting Principle 6 are unhelpful given this will be disapplied where Principle 12 applies. Also of note is the definition used for "retail customer," which differs from that proposed for the Duty. Furthermore, the scope of the consultation includes a definition of "consumer" that encapsulates "the wider group of those who use financial services." The FCA should provide further guidance on how these similar and related definitions interact.

[20] https://www.fca.org.uk/publication/finalised-guidance/fg21-1.pdf.

127. Firms should not be faced with a predicament about which set of guidance they need to comply with. If the intended benefits are to be achieved and confusion for firms, customers and the FOS to be avoided, the FCA should ensure that the Duty and the Vulnerability Guidance are aligned.

128. We note that the FCA's proposals are designed to encourage the delivery of good outcomes for two types of customer who can receive systematically poorer outcomes: those with characteristics of vulnerability and those who share protected characteristics under the Equality Act (or equivalent non-discrimination legislation in Northern Ireland). We note that the FCA's explanation in paragraph 11.17 of the consultation that it intends the Duty to embed its thinking on diversity and inclusion (D&I) into wider frameworks as an alternative to introducing a standalone D&I regime. We do not object to this approach.

129. However, paragraph 2A.1.6 of the draft non-Handbook guidance appears to ask firms to conflate D&I and socioeconomic factors with vulnerability factors. This makes interpreting these concepts challenging. While we understand that there is some correlation of these factors with vulnerability, the FCA has not made the case that they are causes of it. Indeed, customers who share protected characteristics may find it deeply upsetting, offensive and/or discriminatory to be characterised as vulnerable due to a factor such as their ethnicity. Furthermore, it is unclear why the FCA is seeking to introduce such factors into its rulemaking ahead of the proper consideration they will receive in the consultation paper that it plans to publish jointly with the Bank of England (BoE)/Prudential Regulation Authority (PRA) later in 2022. Without a firm evidence base, the FCA risks unnecessarily pushing firms to treat all consumers as if they were vulnerable.

130. One of the ways markets have evolved to take account of the diverse needs of customers is in different firms developing different business and operating models to target specific customer groups and service specific needs. The draft rules and guidance do not acknowledge this or that firms can comply with their obligations in a way that reflects their business and operating model. As a consequence, the introduction of the Duty could reduce the scope for competitive differentiation, to the detriment of customers across the market negatively. Greater homogeneity in compliance may also negatively affect innovation and raise barriers to entry for new market participants that identify an underserved customer need. The guidance should therefore expressly acknowledge that firms can comply with the Duty in different and proportionate ways. (See also our answer to question 17 below.)

131. We have commented on privacy and data-protection issues in our answers to questions 3, 4, 8 and 11 above. We also note that the obligations to consider customers' diverse needs presuppose the availability to firms of data on demographic groups. Some firms may not have access to such information.

Q14. Do you have views on the desirability of the further potential changes outlined in paragraph 11.19?

132. As noted in our answer to question 13 above, it would be premature to comment further on D&I issues in the context of the Duty ahead of the consultation that the FCA plans to publish jointly with the BoE/PRA later this year.

133. As we also note in our answer to question 13 above, D&I and socioeconomic factors should not be conflated with vulnerability factors. The finalised rules and guidance should treat these concepts consistently.

Q15. Do you agree with our proposal not to attach a private right of action to any aspects of the Consumer Duty at this time?

134. We agree with the proposal not to attach a private right of action (PROA) to any aspects of the Duty. As we argued in our response to the first consultation, a PROA would see the FCA lose its position as sole arbiter of its Handbook and instead become one of at least two arbiters, alongside the courts. This would create a real risk of conflicting interpretation of its rules and guidance, undermining the regulatory predictability that firms, investors and customers require. A PROA would also likely have a stifling effect on innovation and competition as firms attempted to mitigate the risk of legal action connected with the vast breadth and scope of the Duty. Moreover, customers already enjoy access to means of seeking redress that are less costly and more accessible than litigation, including making a complaint to a firm, having their case considered by the FOS or the Business Banking Resolution Service, or seeking recourse via FCA consumer-redress schemes or the Financial Services Compensation Scheme. Given the high costs involved in taking a case to court, introducing a PROA would also likely lead to a two-tier system for customer redress, bifurcated between those with the means to take their case to the courts and those for whom the existing mechanisms for redress are the only affordable options. We welcome the FCA's recognition of these arguments and its conclusion that a PROA would not ultimately be in the interests of consumers. Indeed, it is difficult to envisage future circumstances in which these arguments would not be equally applicable, but we would expect the FCA to consult fully on the basis of an appropriate CBA if it were to revisit its decision in the future.

135. We nonetheless remain concerned about the role that the FOS will play in interpreting the Duty. The discretion that it enjoys in determining complaints according to what is, in its opinion, "fair and reasonable in all the circumstances of the case" means that a degree of legal certainty and consistency is foregone in pursuit of an efficient, low-cost dispute-resolution process. As we argued in our response to HMT's phase-II consultation on the FRF review,[21] while this approach is justified for most cases brought to the FOS that are decided on their specific facts, it can be problematic when applied to a large number of similar cases that hinge on the FOS's interpretation of relevant laws or regulatory requirements, particularly where these are novel.

136. This general problem is particularly acute in the case of the Duty given the subjective nature of many of the concepts it introduces (e.g. acting reasonably), the residual uncertainty (highlighted in this response) about the FCA's expectations of firms in securing the four outcomes, and its breadth of scope (meaning it is likely to be a relevant consideration in a significant portion of disputes brought to the FOS). It is therefore vital that the FOS's interpretation of the expectations of firms imposed by the Duty is consistent both with the FCA's intentions and between cases. Without such consistency, firms will adopt a risk-averse approach, assuming the most stringent interpretation of the Duty in their design of products and services and their interactions

[21] https://www.ukfinance.org.uk/policy-and-guidance/consultation-responses/uk-finance-response-financial-services-future-regulatory-framework-review-phase-ii-consultation.

with customers. This risks the withdrawal of products and services deemed too risky and/or costly to provide, disproportionately affecting those customers already susceptible to financial exclusion.

137. These risks must be addressed by the public authorities during and after the implementation period. We welcome the FCA's intention to work closely with the FOS to identify issues with the application of the Duty to relevant cases and to update guidance for firms accordingly. An industry forum involving the FCA and the FOS would be helpful, and we are encouraged by reference to this in the FOS's publication last month of a Wider Implications Framework.[22] However, firms need more than intentions to form the basis of investment decisions, and we look to the FCA and the FOS to take the necessary actions, whether in the implementation of the Duty itself, through amendments to DISP or under the auspices of their joint memorandum of understanding. To this extent, we welcome recognition in the FOS's January 2022 statement on a wider-implications framework of the need for close coordination where the Duty is concerned.[23] Any action should include a commitment that the standards expected by the Duty will not be applied in adjudicating cases that predate its introduction.

138. If the ability of the FCA and the FOS to deliver the certainty and consistency of interpretation that firms require is ultimately limited by their respective statutory roles, HMT must intervene to preserve it.

Q16. Do you have any comments on our proposed implementation timetable?

139. We understand the FCA's desire for firms to move swiftly to deliver enhanced protection for consumers. However, the proposed implementation period is simply too short. It also cannot be predicated on firms starting to implement the Duty before its requirements are finalised and the FCA formally introduces it. It would be unlawful as a matter of public decision-making for the FCA to expect firms to take steps (including "to begin implementation") in relation to the Duty before then, not least as the FCA is subject to no statutory requirements in this regard. So short an implementation period, for an initiative intended to drive a step change in firm culture and behaviour, is likely to have negative consequences that could otherwise be avoided and undermine the enhanced consumer protection that the Duty is intended to deliver.

- **High opportunity cost.** Firms will have to devote a significant portion of their resources to ensuring full compliance with the Duty by the implementation date. This is likely to limit their ability to advance other initiatives, both mandatory and commercial, that would provide value to their customers. This, in turn, is likely to be disproportionately problematic for smaller firms (e.g. third-country branches) for which compliance will represent a larger share of their overall investment budgets. Allowing the costs of implementing the Duty to be spread over a longer period would free up and/or facilitate access to the scarce resources that firms require to continue to progress other initiatives and better respect the regulatory principle of proportionality to which the FCA must have regard.

[22] https://www.financial-ombudsman.org.uk/who-we-are/work-other-organisations/wider-implications-framework#:~:text=The%20Wider%20Implications%20Framework%20is,across%20the%20financial%20services%20industry.
[23] https://www.financial-ombudsman.org.uk/who-we-are/work-other-organisations/wider-implications-framework.

- **Conflicting requirements.** As we note in our answers to questions 6 and 7 above, there is considerable inconsistency and tension between the Duty and current Handbook requirements. Firms should not face conflicting requirements from the date that the Duty is introduced. Identifying and resolving these conflicts will be a significant exercise, and we are doubtful that the proposed implementation timeline allows sufficient time for it to be carried out thoroughly.

- **Financial exclusion.** Faced with such a short implementation period, it is likely that firms will take a more risk-averse approach to ensuring the compliance of their products, services and communications with the Duty. For lack of time to seek advice and for dialogue with the FCA and the FOS, firms might understandably opt for the lower-risk option of withdrawing some products and services entirely where the requirements of the Duty are unclear. As we have argued above, this is likely to disproportionately affect customers already at greater risk of financial exclusion.

- **Risk-based approach to implementation.** An inadequate implementation period will require firms to prioritise what they can achieve in those timescales. Even where they do not withdraw products entirely, they may, out of necessity, seek to identify the minimum change that can be undertaken to nominally meet the requirements of the Duty without effecting the underlying change in culture or practices that the FCA desires.

140. The work that firms will need to undertake to implement the Duty is extensive. It includes:

- initial scoping and gap analysis. This, on its own, will be a challenging undertaking given the breadth and depth of the Duty's requirements. It will need to encompass practically every part of a firm's business, including all products and services provided to the widest definition of retail customer. This means running large numbers of gap-analysis workstreams, across all organisational entities and their components, against the rules and guidance. This could only hope to provide an initial view and grouping of major gaps and likely development priorities and to drive out ambiguities in the Duty and areas where policy interpretation and development will be required. Further iterations of the gap analysis are inevitable as a firm develops more understanding and clarity of the requirements in individual areas and seeks to translate the rules into defined and actionable development. We envisage this stage of implementation alone will take several months for a reasonable-sized firm;

- understanding the Duty's relationship and integration with existing and ongoing strategic and regulatory developments within firms. This is likely to be complex to resolve, including critical decisions on funding approval and identifying other developments to discontinue to accommodate additional costs. Once again, these processes will require time to resolve, along with coordination with funding cycles and governance;

- mobilising priority actions and phasing. The range of potential development work is extensive, cutting across frameworks, policies, processes, systems, communications, monitoring, reporting, governance, internal awareness, training and more;

- full review of product prices, terms and conditions as well as (where applicable) the General Investment Conditions (which govern all savings accounts) and the Mortgage Terms and Conditions (which govern all mortgages). In particular, the price-and-value outcome and associated guidance anticipates that firms will carry out extensive and fairly granular assessments of the value of their products, to include intangible factors such as non-financial costs and the potential impact of vulnerability characteristics. While it is feasible for firms to design new frameworks for fair-value assessments and start to implement these in practice by April 2023, we do not think it is realistic to expect firms to have finished the exercise by that date, let alone to have been able to address any distribution-chain implications given that this will depend partly on the actions of third parties (e.g. to provide data) outwith their full control;

- business-impact analysis (BIA) of product development and design, origination, servicing, redemption and retirement;

- BIA of induction and annual training as well as any individual departmental training;

- BIA of the full suite of customer documentation and communications (including letters, websites, marketing and third-party communications) and complaints processes;

- implementation of changes to the above (including standardising and ensuring appropriate consistency across a firm's full range of in-scope products and services) and communications, briefing sessions and roll-out to all staff;

- IT system changes for gaps and enhancements identified from the above and to facilitate process changes. A mere subset of these could require a firm to deploy technology in respect of its digital channels (which could well be its highest in volume) so that it can—

    - maintain robust records of important digital sessions, equivalent to recording every telephone call;

    - monitor every session for signs of customers who are struggling with content, comprehension or process;

    - ensure customers are getting good outcomes and not suffering harm;

    - identify and support customers who need help;

    - resolve complaints and prevent recurrences; and

    - evidence to the FCA that the Duty's requirements have been met.

    This could only start once a firm has decided the products and services that will meet the Duty's requirements. Depending on the solution chosen and the firm's operating model, this alone could take six months to two years to implement depending on factors including hosting (on premise or in the cloud), tagging requirements, size and complexity of website, IT and security policies, testing requirements, training, and design and integration of data with wider reporting requirements.

Given the role that appropriate technology can play here, the FCA should provide clearer guidance, equivalent to what largely exists now for call recording, that firms can use it to achieve the Duty's outcomes where this is consistent with privacy and data-protection legislation;

- reviewing distribution-chain arrangements;
- reviewing key performance and risk indicators and analysing and developing management information so that it is tailored to monitor delivery of the Consumer Principle and outcomes;
- building out key capabilities, in particular in relation to data and customer services;
- aligning the Duty framework to the internal SM&CR framework; and
- managing integration and interdependencies with other change initiatives that need to be delivered.

141. Given these risks and challenges and the FCA's positioning of the Duty as the cornerstone of its regulatory-change agenda, intended to drive a fundamental shift in firm culture and behaviour, full implementation cannot be achieved in just nine months. Rather, we recommend at least two years from the date that the Duty is formally introduced.

142. As a comparison:

- the Vulnerability Guidance is more focused but many firms are still working toward full implementation after more than a year;
- firms had up to 16 months from the date that final rules were published to implement annual fair-value assessments required by changes to PROD following the FCA's market study on general-insurance pricing practices;[24] and
- we note the much more reasonable timelines and two-stage approach proposed for implementation of the new operational-resilience requirements.[25] Here, one year is being allowed for the initial activity of identifying firms' "important business services," setting tolerances, mapping processes and putting appropriate governance frameworks in place. This will be followed by a further three-year period to enable firms to increase the resilience of those services to an appropriate level.

143. Meanwhile, Covid-19 continues to affect firms, requiring higher levels of direct customer support, enhanced systems and processes in response to market changes, and mitigation of staff absences. Many of these factors have long tail impacts, and it is unclear when they will be alleviated. Where scarce resources cannot stretch to both implementing regulatory change and supporting customers through the pandemic, firms will continue to put day-to-day customer support first. Even where additional contractor resource would practically assist and could be bought in, this will increase implementation costs (which are already high) and inhibit ownership and embedding of changes by firms' own staff.

[24] https://www.fca.org.uk/publication/policy/ps21-5.pdf.
[25] https://www.fca.org.uk/publication/policy/ps21-3-operational-resilience.pdf.

144. Finally, the November 2021 version of the Regulatory Initiatives Grid itself noted "the significant volume of work underway at regulators and firms."[26] Key initiatives over the period during which the FCA envisages firms implementing the Duty include:

- improving energy performance through lenders. Alongside related climate-change initiatives, this is likely to involve extensive work, especially on back books;
- access to cash;
- D&I in financial services;
- operational-resilience requirements;
- statutory debt-repayment plans;
- the BoE's approach to assessing resolvability of mid-tier firms;
- new requirements for deferred-payment credit;
- priority interventions by the PSR (e.g. APP scam prevention and confirmation of payee) to protect the interests of customers and businesses; and
- initiatives addressing the scope and standard of regulation of financial promotions.

145. Some members nonetheless believe there is scope for a phased approach, and we would be willing to explore this with the FCA.

146. We welcome the FCA's readiness to interact with firms during the implementation period. The FCA should adopt a test-and-learn approach so that it, firms and the FOS (as discussed in our answer to question 15 above) can discuss and address issues as they arise, including by updating relevant guidance. Such an approach should be codified as early as possible as it will be an important factor in firms' approach to implementing the Duty. In particular, the FCA will need to afford the access that they need to flexibly supervised firms, particularly where these constitute most or all of an industry sector (e.g. building societies). The FCA should also recognise that information requests can be time consuming and resource intensive and are likely to fall to the same resource working on implementation, particularly in smaller firms.

Q17. Do you have any comments on our proposed approach to monitoring the Consumer Duty and the related draft rules and non-Handbook guidance?

147. The FCA's monitoring expectations will necessitate greater collection of customer data as firms will be required to engage in continual review, testing and record-keeping. On this, we reiterate the points made in our answers to questions 3, 4, 8 and 11 above about privacy and data protection and in our answers to questions 4, 13, 14, 15 and 16 about D&I. Firms will need more time than the nine months proposed to build out and embed these capabilities as they do not have a clear idea of the metrics they will be required to follow or the extent to which they will need to review. In many cases, consumer input will also be required.

[26] https://www.fca.org.uk/publication/corporate/regulatory-intitiatives-grid-november-2021.pdf.

148. Detailed guidance, informed by industry engagement, is helpful in enabling firms to decide on their approach to compliance. The draft non-Handbook guidance presents a detailed list of information that firms "may" gather and record and produce to the FCA on demand. As guidance is not binding, firms should have the flexibility to conduct monitoring in a proportionate manner best suited to their business and operating model. Given the FCA's statements in EG 2.9.4 on the relevance of guidance in assessing compliance and the lack of tangible detail in the consultation on its planned enforcement and supervision approach, it would be helpful if the non-Handbook guidance on monitoring expressly acknowledged that firms are free to follow the monitoring guidance proportionately rather than necessarily exhaustively. Furthermore, clarifying in guidance that firms have a legitimate interest in processing personal data to comply with the Duty would help them establish a legal basis under GDPR for collecting and storing customer data for this purpose, with some flexibility as to the exact data collection and storage to be adopted.

149. One potential impact of the new proposals is that a concern seen at one firm may spark a market-wide data-collection exercise. The FCA should provide assurance that this is not likely to be a regular feature of its supervision of the Duty.

Q18. Do you have any comments on our proposal to amend the individual conduct rules in COCON and the related draft rule and non-Handbook guidance?

150. We note that, mirroring the proposed replacement of Principles 6 and 7 with Principle 12, Conduct Rule 4 would be replaced by Conduct Rule 6 where the Duty applies. The draft guidance supporting the draft COCON rules clarifies that an employee's obligations under Conduct Rule 6 will be dictated by what it is reasonable to expect from a prudent employee in a similar position. Draft guidance COCON 4.1.25-4.1.33 also makes clear that employees' level of seniority will have a strong bearing on the extent to which they are expected to analyse and suggest changes to the firm's systems and processes or policies and procedures. The rules and guidance therefore add complexity, involving a fundamental change in the nature of the conduct rules, from simple conduct rules that apply to all relevant staff toward the application of a new, more complex rule (placing a positive obligation on individual employees to apply the cross-cutting rules) to some staff some of the time. This risks undermining the strength of the existing COCON approach and setting a precedent for future changes moving even further away from the "simple and universal" model. It should not be undertaken without serious consideration of the implications.

151. Without much clearer guidance on what the FCA envisages Conduct Rule 6 will reasonably require from employees at different levels of seniority and in a variety of different scenarios, it is difficult to see how firms can put in place suitable procedures to police all employees' compliance and/or internally report breaches of Conduct Rule 6 or how they can avoid placing individual employees at all levels in a position of having to be arbiters of good outcomes themselves. We are also concerned about how compliance will be assessed by the FCA itself, particularly how, without the benefit of hindsight, the FCA will assess whether harm was foreseeable at the relevant time.

152. We are also concerned that an unintended consequence of the new Conduct Rule and the positive obligations it places on individuals will be to introduce a level of personal risk that will reduce the pool of individuals willing to take on roles related to a firm's retail-market business. Those who do undertake such roles may require a "risk

premium" in the form of higher compensation, which will ultimately be passed on to consumers. Such considerations have not been factored into the FCA's CBA.

153. It will be important for both the FCA and the PRA to update the supporting documentation for conduct rules to ensure consistency and clarity within the process for dual-regulated firms.

154. Separately but relatedly, the FCA states that "firms are not consistently and sufficiently prioritising good consumer outcomes," but its intended purpose for conduct-risk frameworks is to produce good consumer outcomes. The FCA should revisit the interplay between conduct risk and PRIN 12.

Q19. Do you have any comments on our cost/benefit analysis?

155. We have significant misgivings about the FCA's CBA. While the FCA seems to have met the minimum requirements currently set out the Financial Services and Markets Act 2000 because of the exceptions available to it, we nevertheless regard the CBA as insufficient given it finds costs to firms in the billions of pounds but does not quantify the benefits, fails to assess alternative options for achieving the intended outcome and does not consider the opportunity cost of firms' investment to comply with the Duty.

156. This demonstrates why HMT is right to propose requirements for greater rigour in regulators' conduct of CBAs as part of its FRF review,[27] and our response to its consultation on proposals for reform included an assessment of the CBA for the Duty as evidence for our support.[28] In addition to the concerns cited above, the FCA has not prepared evidence to support a theory of change, there is no substantiation of key assumptions, costs are presented using a broad range that highlights the level of potential uncertainty of the intervention, and no further sensitivity analysis is conducted. These factors raise questions about the robustness of the analysis supporting the Duty, introducing a risk that firms will be burdened with significant costs for limited benefits.

157. The FCA has also not indicated when or how it will undertake a post-implementation review of the Duty or how this will affect reviews (e.g. of the needs of older customers or of the Vulnerability Guidance) that are planned. It should do so. However, if not addressed, the weaknesses in its CBA will inevitably make it more difficult to judge whether the Duty has achieved its desired effect.

Q20. Do you have any other comments on the draft non-Handbook guidance?

Q21. Can you suggest any other examples you consider would be useful to include in the draft non-Handbook guidance?

158. See annex 2.

159. See annex 3 for other comments on the draft Handbook text.

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[27] See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf

[28] https://www.ukfinance.org.uk/system/files/UK%20Finance%20response%20to%20FRF%20consultation%20on%20proposals%20for%20reform.pdf.

Annex 1

Inconsistencies and tensions with the Handbook

Handbook guidance related to Principles 6 and 7

160. The FCA has proposed to disapply Principles 6 and 7 where the Consumer Duty applies but sees merit in continuing to require firms to comply with "*formal" and "existing" guidance* on those Principles. Retaining the overlapping guidance is confusing and imposes an unnecessary burden on firms. In particular, there does not appear to be merit for Handbook guidance on Principles 6 and 7 to continue to apply.

161. The following types of Handbook guidance on Principles 6 and 7 may need to be disapplied or amended (e.g. to refer additionally to Principle 12 and explain how it is applicable) to minimise conflicting requirements.

Handbook guidance that sets out the purpose of a particular set of requirements

162. For example:

- COBS 6.1E.2—"A platform service provider should pay due regard to its obligations under Principle 6 (Customers' interests), Principle 7 (Communications with clients) and the client's best interests rule, and ensure that it presents retail investment products without bias."

- MCOB 2.3.1—"The purpose of MCOB 2.3 is to ensure, in accordance with Principles 1, 6 and 8, that a firm does not conduct business under arrangements that might give rise to a conflict with its duty to customers or to unfair treatment of them."

- MCOB 3A.1.11—"Firms are reminded that financial promotions (including those which are exempt) may be subject to more general rules, including Principle 7 (Communications with clients), SYSC 3 to SYSC 10 (Systems and controls), and MCOB 3A.2.4 R (Fair, clear and not misleading communications)."

- BCOBS 2.1.1—"Principle 6 requires a firm to pay due regard to the interests of its customers and treat them fairly. Principle 7 requires a firm to pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading. . . . This chapter reinforces these requirements by requiring a firm . . ."

- CONC 1.1.4—"The Principles for Businesses (PRIN) apply as a whole to firms with respect to credit-related regulated activities . . . In carrying on their activities, firms should pay particular attention to their obligations under . . . Principle 6 . . . Principle 7 . . ."

- CONC 8.10.4—"It is likely to be a contravention of the Principles, for example Principles 6 and Principle 7, where a firm . . ."

Handbook guidance that specifically relates to how firms should comply with Principles 6 or 7

163. For example:

- COBS 6.1A.16—"To meet its responsibilities under the client's best interests rule and Principle 6 (Customers' interests): (1) a firm should consider whether the personal recommendation or any other related service is likely to be of value to the retail client . . ."

- MCOB 2.4.3—"Principle 7 (Communications with clients) requires that a firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading. This means, for example, . . ."

- MCOB 2.6A.5C—"In the light of MCOB 2.6A.5BR (1)(c), and in accordance with Principle 6, a firm should not seek to prevent a tenant in Northern Ireland from ending the tenancy on less than the agreed notice period (not exceeding three months in accordance with MCOB 2.6A.5BR (1)(c)), where the notice is given in the first six months of the tenancy."

- MCOB 3A.1.17—"This chapter amplifies, for activities within its scope, Principle 6 (Customers' interests) and Principle 7 (Communications with clients)."

- BCOBS 5.1.3A—"To ensure compliance with its obligations under BCOBS 5.1.1 R and Principle 6, on any occasion where it proposes to exercise a right of set-off, a firm (other than a credit union) should, with respect to its dealings with consumers . . ."

- CONC 5C.4.2—"A firm that makes changes as described in CONC 5C.4.1R should, in accordance with Principle 6, have due regard to the interests of existing customers and treat them fairly. An example of such a change is a change in a customer's overdraft limit."

Rules and guidance that require firms to act in the best interest of customers

164. Some rules and guidance that require firms to act in the best interest of clients may need to be disapplied or otherwise amended to reflect the Consumer Principle of "good outcomes" in circumstances where the Duty applies. This would reflect the FCA's proposed requirement of firms to act to deliver good outcomes for retail clients (as opposed to acting in their best interest). For example:

- COBS 2.1.1—"(1) A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule)."

- References to the "client's best interests rule" in COBS.

165. The following guidance and evidential provisions provide examples of arrangements that the FCA believes will breach the client's best interests rule if a firm sells or arranges the sale of a packaged product for a retail client:

- MCOB 2.5A.1—"A firm must act honestly, fairly and professionally in accordance with the best interests of its customer."

- MCOB 4.7A.16—"An attempt by the firm to misdescribe the customer's purpose or to encourage the customer to tailor the amount he wishes to borrow so that MCOB 4.7A.15 R does not apply may be relied on as tending to show contravention of MCOB 2.5A.1 R (The customer's best interests)."

- PROD 3.3.1—"A distributor must . . . ensure that financial instruments are distributed only when this is in the best interests of the client . . ."

- PROD 4.3.6B—"(4) The arrangements a distributor is required to have in place under PROD 4.3 are separate from the processes and arrangements the firm should have in place at the point of sale, including to comply with the customer's best interests rule and to determine whether a product being proposed is consistent with the demands and needs of a particular customer."

Rules and guidance that prescribe the information that must be provided to the customer

166. Some FCA rules require firms to provide information to customers in a prescribed form and containing specific types of information. It is not clear if the Duty is intended to override such prescriptive requirements, so we recommend that the FCA make clear compliance with such existing disclosure rules takes precedence over compliance with the Duty. Examples of such requirements include:

    - distance-marketing information (e.g. ICOBS 3 and BCOBS 3 etc.);

    - MCOB 5.6—content of illustrations for regulated mortgage contracts;

    - MCOB 5A.5—content of ESISs. Firms are restricted in the information that can be provided outside the ESIS requirements even if this would be clearer and aid consumer understanding. There is little room for firms to go over and beyond the MCOB requirement, with MCOB 5.A.5.5 requiring that the ESIS must contain only the material prescribed and no other material;

    - MCOB 6.4 – content of offer letters (which includes modifications that can be made to the illustration);

    - MCOB 9.4—content of illustrations for equity-release products;

    - BCOBS 2.2A—summary box for savings accounts; and

    - the assumption in DISP *inter alia* that correspondence will be provided in paper form (e.g. with requirements for messages to be in writing or the FOS leaflet to be enclosed) even where consumers would prefer to be contacted by email.

Mortgages

Overall

167. As illustrated above, there are multiple references to Principles 6 and 7 in MCOB, such that simply disapplying them in favour of Principle 12 may not work. Moreover, detailed provisions variously refer to:

- conflict with the interests of customers (MCOB 2.3.4);
- reliance on others (MCOB 2.5);
- acting honestly, fairly and professionally in accordance with the best interests of customers (MCOB 2.5A.1);
- communicating in a way that is fair, clear and not misleading (MCOB 3A.2.1); and
- treating customers fairly (MCOB 11.5.1).

168. Disapplying Principles 6 and 7 will not remove these provisions, which do not seem to be compatible with the approach or requirements of the Duty.

Arrears and repossessions

169. It is unclear how MCOB 13 will generally interact with the Duty.

Lenders without advice permissions

170. MCOB 4.8A bars mortgage firms without advice permissions from providing any personalised information to customers other than as part of full advice. This includes:

- providing customers with an indication of the monthly costs of a regulated mortgage contract if the indication is personalised to the customer in any way (e.g. by detailing the monthly cost, the amount that the customer wishes to borrow or the term over which the customer wishes to borrow it); and
- calling a customer to tell them that an application for a regulated mortgage contract needs to be submitted within a particular timeframe if a new (higher) interest rate is not to apply, if the call is about a particular regulated mortgage contract for which the firm knows or reasonably suspects the customer may wish to apply and the product that will replace it or the rate that will apply if an application for such a product is received after a particular date.

171. Paragraph 9.36 of the consultation notes that this issue was raised by firms, stating: “Our expectations under this outcome, as for other elements of the Consumer Duty, would be informed by the firm’s role. If they are not authorised to provide advice, or a customer relationship is on a non-advised basis, we would not expect firms to provide advice.” Paragraph 9.37 states that the FCA is “wary of reducing the consumer protections that currently apply for advice,” so personalised information cannot seemingly be provided. We nonetheless maintain that the conflict with the consumer-understanding outcome for mortgage lenders without advice permissions exists.

Capitalisation

172. MCOB 13.3.4A refers to customers in payment difficulties and that, "(1) a firm must consider whether, given the individual circumstances of the customer, it is appropriate to do one or more of the following in relation to the regulated mortgage contract or home purchase plan with the agreement of the customer . . . (d) treat the payment shortfall as if it was part of the original amount provided (but a firm must not automatically capitalise a payment shortfall where the impact would be material)." However, MCOB 13.3.4D states that "in order to comply with Principle 6 firms should not agree to capitalise a payment shortfall save where no other option is realistically available to assist the customer."

173. The FCA expects firms to focus on delivering good outcomes for customers, but MCOB 13.3.4D theoretically prevents capitalisation taking place as there will always be other options available, even where capitalisation is in the best interests of consumers. It is not clear that the Duty would override this.

Consumer credit

174. CONC 7.17 (notice of sums in arrears) requires lenders to send payment reminders at specific timings and with specific content. This has, on occasion, caused unnecessary confusion or distress to non-limited businesses that, having entered into an agreed forbearance option, continue to receive these notices as per the Handbook. Adhering to this rule does not seem consistent with the outcomes required by the Duty.

Other specific rules that may be incompatible with the Duty

175. BCOBS 4.2.1 (1)(a)—a firm is not required to provide or make available to a banking customer regular statements of account where the firm has provided the banking customer with a pass book. Good outcomes may not be delivered to such customers as a pass book requires the customer to visit a branch to update it.

Annex 2

Other comments on draft non-Handbook guidance

Guidance paragraph	FCA's intention (consultation paragraph)	Comment
Introduction		
1.9: "We use 'consumer' when talking about the wider group of those who use financial services. We use 'customer' when talking about an individual firm's customers or potential customers."	—	We suggest the guidance clarify that the terms "customer" and "client" only apply to retail. This aligns with the language in Principle 12 and the draft rules in PRIN 2A and would help to clarify that the guidance does not apply to wholesale firms' clients.
The products-and-services outcome		
5.32: "Firms should not distribute a product or service if they do not understand it sufficiently."	8.18: "We also propose that distributors must not distribute products or services unless they are satisfied that their distribution arrangements are consistent with the product or service providing fair value. To do this, 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 value."	The guidance is too vague. It should include the FCA's intention so that, although not binding, it can be considered when the FCA determines whether firms have complied with the relevant rule.
5.37: "When distributors set up or apply a specific distribution strategy for a product or service, they should obtain information from the manufacturer to identify the appropriate distribution strategy and ensure the product or service will be distributed appropriately for the target market."	7.24: "We propose to introduce requirements for distributors, including the need to get information from the manufacturer to understand the product or service, its target market and its intended distribution strategy."	The guidance is too vague. It should include the FCA's intention so that, although not binding, it can be considered when the FCA determines whether firms have complied with the relevant rule.

Guidance paragraph	FCA's intention (consultation paragraph)	Comment
The price and value outcome		
6.28: "When considering the price charged, manufacturer firms should consider all the costs and charges a consumer may pay for the product or service over time. For example, firms should consider: • The charges consumers pay at the start and end of a contract. . . ."	—	Wholesale firms will often set a wholesale price for a product they manufacture that will incorporate aspects relating to the wholesale relationship between the wholesale firm and the distributor. The wholesale firm, as manufacturer, will comply with MiFID II/PROD in terms of costs and charges. It would be helpful for the guidance to reflect the impact of draft PRIN 2A.3.30 and say explicitly that, in these circumstances, the manufacturer's compliance with those obligations will suffice.
6.34: "All firms in the distribution chain are responsible for the value of the prices that they control. However, the firm at the end of the distribution chain has responsibility to ensure consumers do not receive poor value. Fees charged by different firms along the distribution chain might together result in a higher overall fee that does not represent fair value for consumers."	—	This creates an undue burden on the firm at the end of the distribution chain as it will ultimately be responsible for the value of a product or service when it has no control over the price set further up the distribution chain. This could result in friction between manufacturers and distributors that affects customer choice.

Annex 3

Other comments on draft Handbook text

Handbook paragraph	FCA's intention (consultation paragraph)	Comment
Amendments to the glossary of definitions		
"non-complex financial instrument"	—	COBS currently uses the term "non-complex financial instrument" without its being defined in the glossary. The new definition seems to be drafted to be relevant across the Handbook. The FCA should confirm that this will not change the application of COBS rules that refer to non-complex financial instruments.
"product"	—	The definition of "product" should exclude the types of product that are not in the Duty's scope (e.g. non-retail financial instruments). It is unclear what "unless the context otherwise requires" means.
"target market"	—	PROD includes a concept of "target market" that is not currently a defined term in the Handbook or the Vulnerability Guidance. The FCA should clarify whether the term as used in PROD will remain undefined or that the new glossary definition will also apply to PROD.

Handbook paragraph	FCA's intention (consultation paragraph)	Comment
"retail customer"	—	As drafted, the definition of "retail customer" links to the definitions of retail in other areas of the FCA Handbook. Those, in turn, link to definitions that use the concept of "client," which is narrower than that of "customer." There may be a gap between the definitions (e.g. if the end customer in a distribution chain is a regulated firm, it may be treated as a "retail customer" for the purposes of PRIN 2A by a firm involved in the initial manufacturing of a product as it would not satisfy the definition of a "professional client" due to not being a client of the manufacturer). We suggest adding to the end of the definition "if such *person* would meet the relevant test above if they were a direct client of the *firm."*
Amendments to the Principles for Business (PRIN)		
2.1.1: 12 Consumer duty—A firm must act to deliver good outcomes for retail customers.	5.20: "A firm must act to deliver good outcomes for retail customers."	"Retail customer" is a much narrower concept than "consumer." Should Principle 12 be renamed the "Retail Customer Duty" for the purposes of clarity?
2A.3.13: "If the results of testing show that the product does not meet the identified needs . . . of the target market . . . the manufacturer must . . . immediately cease marketing or distributing the product . . ."	—	It would be helpful to have guidance clarifying what would constitute ceasing distributing the product in the case of a mortgage. This should allow the pipeline of applications to complete (potentially mitigating the identified risk by flagging the risks of proceeding to customers and their advisors) given the risk of material detriment to customers if an application or offer is cancelled.

Handbook paragraph	FCA's intention (consultation paragraph)	Comment
2A.3.23: "(1) A distributor must regularly review its distribution arrangements to ensure that they are still appropriate and up to date. (2) When reviewing the distribution arrangements, a distributor must verify that each product is distributed to the identified target market."	7.24: "We propose to introduce requirements for distributors, including the need to . . . 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."	It is unclear whether this will onerously require mortgage brokers to fit customers into granular target markets and how that fits with a broker's obligation to recommend a suitable product.
2A.3.24: "Where appropriate, in view of the outcome of a review, a distributor must . . . (3) promptly inform each other person in the distribution chain about the remedial action taken."	7.24 as above.	This is impractical and disproportionate for whole-of-market advisors who make one-off sales of a manufacturer's product where it is considered the most suitable for that particular customer.
2A.3.28: ". . . (2) Compliance with (1) may be relied on as tending to establish compliance with PRIN 2A.3."	6.52: ". . . Where existing rules require manufacturer and distributor firms to assess whether the price of their products and services provides fair value and to review this regularly, they will comply with the price and value outcome. However, the Consumer Duty as a whole is broader than these requirements, so firms still need to consider if they meet all other aspects of the Consumer Duty."	It is unclear whether the FCA intends to have substantially different approaches to compliance with PROD/COLL as a way of complying with PRIN and the product-and-services and price-and-value outcomes. They should be the same, suggesting draft PRIN 2A.3.28 should read, "(2) Compliance with (1) <u>is evidence of</u> compliance with PRIN 2A.3."
2A.4.1: "For the purposes of this outcome: (1) value is the relationship between the amount paid by a retail customer for the product and the benefits they can reasonably expect to get from the product; and (2) a product provides fair value where the amount paid for the product is reasonable relative to the benefits of the product."	1.16: "Value is the relationship between the overall price paid by the customer and the benefits they receive."	Paragraph 1 of the draft rule is more onerous than the FCA's intention and introduces a subjective element into the definition. Value should be defined simply as the relationship between price and benefits, per the intention.
2A.4.6: "Where a product is intended to be provided with one or more other products, a manufacturer must ensure that: (a) each component product; and (b) the package as a whole provides fair value to retail customers in the target market.	—	It should be clarified that where a product has multiple benefits but they cannot be bought separately, it is a single product, so either this rule does not apply or only subparagraph (b) applies since the components cannot be assessed separately.

Handbook paragraph	FCA's intention (consultation paragraph)	Comment
2A.4.21: "The manufacturer of a product must ensure that firms distributing the product have all necessary information to understand the value that the product is intended to provide to a retail customer."	8.18: distributors "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 value."	The draft rule places the onus on the manufacturer, whereas this is not the FCA's intention. We also note that PROD 3.3.3 and 4.3.1 place the duty on the distributor to obtain information from the manufacturer. This onus should fall clearly on the distributor.
2A.4.25: "For the purposes of PRIN 2A.2.24R, vested contractual rights include the following: (1) payments already due under the terms of the contract; (2) remuneration for services wholly provided under the contract; and (3) remuneration for services partly provided."	—	We believe the reference should be to PRIN 2A.4.24R.
2A.4.30: "(2) Compliance with (1) may be relied on as tending to establish compliance with PRIN 2A.4."	6.52: ". . . Where existing rules require manufacturer and distributor firms to assess whether the price of their products and services provides fair value and to review this regularly, they will comply with the price and value outcome. However, the Consumer Duty as a whole is broader than these requirements, so firms still need to consider if they meet all other aspects of the Consumer Duty."	As for draft PRIN 2A.3.28 above, this should read, "(2) Compliance with (1) <u>is evidence of</u> compliance with PRIN 2A.4."
2A.5.8: "(1) A firm must: (a) test communications before communicating them to retail customers; and (b) (as set out in PRIN 2A.8.5R) regularly monitor the impact of the communications once they have been communicated, to identify whether it is delivering good outcomes for retail customers."	9.28-9.33 and 9.38: "We expect that testing consumer understanding is unlikely to be required for many communications, for example where there is no significant risk of harm to the consumer" (9.30).	The factors in draft PRIN 2A.5.10 that a firm should consider when determining whether testing of communications is appropriate does not include "where there is no significant risk of harm to consumer." It should.

Handbook paragraph	FCA's intention (consultation paragraph)	Comment
2A.8.3: "To the extent that a firm is also required to carry out specific monitoring or reviews under any of the outcomes in PRIN 2A.3 to PRIN 2A.6, the specific monitoring or reviews form part of the general monitoring required by this section and firms may utilise the information gathered through these processes in preparing the report required under PRIN 2A.8.12R."	—	We believe the last reference should be to PRIN 2A.8.15R.