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Consumer Duty

Best practice for advisers

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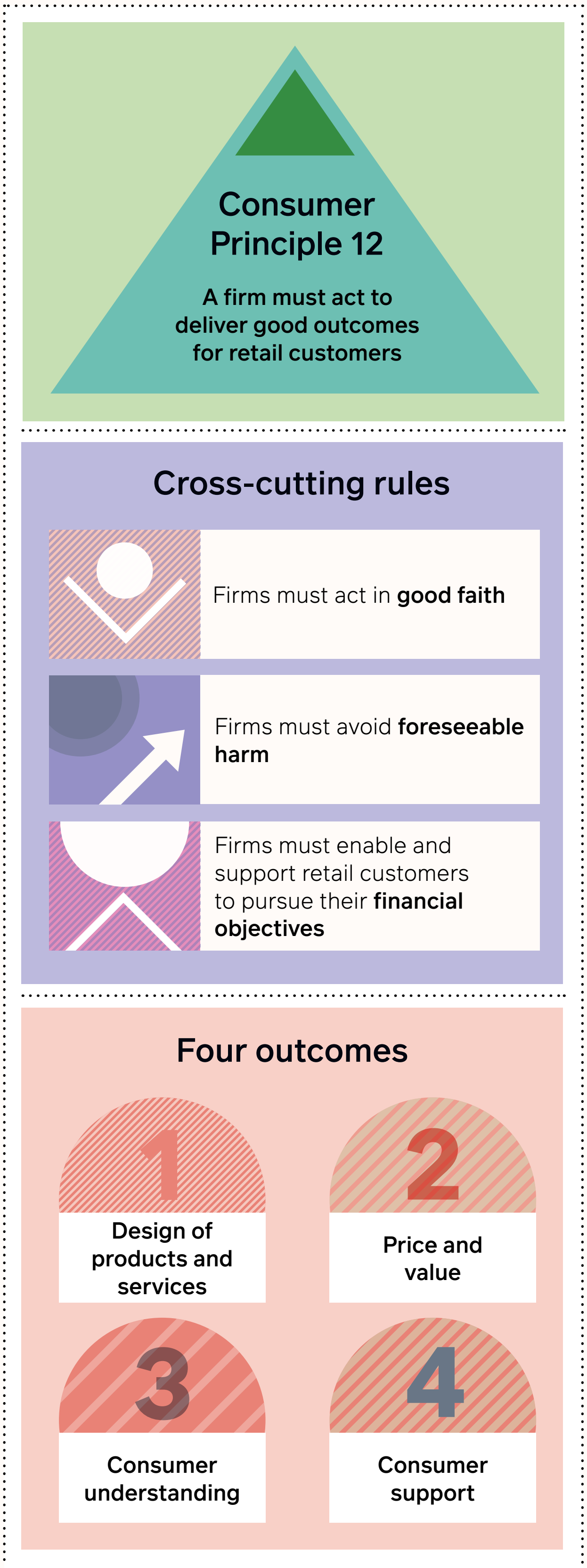
Contents

The overriding principles of Consumer Duty



At the heart of the duty are clear objectives: to ensure a higher and more consistent standard of consumer protection for users of financial services, and to foresee and prevent potential harm. It says that prioritising good customer outcomes must be as important to a board or leadership team as financial performance, risk and strategy.

The Consumer Duty has been introduced not as an add-on to the FCA's rules but to underpin all its rules. It's the cornerstone of the regulator's strategy of setting higher standards and putting consumers' needs first.

The duty applies across the regulated retail financial services industry. It's not just for Financial Advisers or retail investments – it applies, for example, equally to banks, general insurers and to the sectors that have newly come under the regulator's remit such as funeral plan providers. The principles behind it, therefore, have to be very broad to be applicable to all the sectors.

The problems the FCA is trying to solve are not actions like fraud and theft – the regulatory and criminal justice system already have mechanisms to deal with these sorts of activities. It's more about complex situations which might be described as legal, but not right. What does the regulator do when firms aren't technically breaking any rules, but any reasonable person looking at the situation would say it feels wrong?

Instead of trying to tackle this by changing individual rules (which is time consuming, difficult and can involve primary legislation), the FCA has for some time been aiming for what it sees as more effective 'outcomes-based' regulation. The basis for this is that consumers don't care if a set of rules has been followed, they care about the outcomes they receive.

The key principle

The Consumer Duty is much more than just a single statement. The key principle is underpinned by a series of cross-cutting rules which are themselves based on four desirable consumer outcomes. But the overarching principle that drives the duty, the new Principle 12, is that a firm 'must act to deliver good outcomes for retail customers'. Your firm must be able to demonstrate that its purpose aligns with its obligations under the duty, that everyone in the business understands this, and that staff are able to challenge where they think the firm isn't delivering.

How Consumer Duty differs from Treating Customers Fairly

At first glance it appears that the new Principle 12 is covering much the same ground as Principle 6 (A firm must pay due regard to the interests of its customers and treat them fairly) and Principle 7 (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). The difference is that the duty goes much further – and to discover why this is the case, we need to look at the cross-cutting rules which sit below it.

Cross-cutting Rules

The three cross-cutting rules spell out the standards of conduct the regulator wants to see in order to deliver good outcomes for customers. These should underpin firms' Consumer Duty strategy.

Cross-cutting rules

Firms must act in **good faith**

Firms must avoid **foreseeable harm**

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

Acting in good faith

The FCA wants evidence of honesty, and fair and open dealing, which is consistent with what a client might reasonably expect. One of its main concerns has been the imbalance of knowledge, expertise, and therefore potential bargaining position between consumers and financial services firms. It's still true to say that consumers are expected to take responsibility for their own choices, but they must have been dealt with openly and honestly if they are going to be able to do that. If, for example, there was evidence that a product was specifically designed to exploit consumers' lack of knowledge and understanding, that would be a clear indicator that the firm wasn't acting in good faith.

Avoiding foreseeable harm

There's an explicit requirement in the rules to avoid causing foreseeable harm to customers. This is more than just a reactive requirement. Firms also need to take proactive steps to avoid causing harm to customers through their conduct, products or services where it's within their control.

Enabling retail customers to pursue their financial objectives

The important point to note about this rule is that it covers the financial objectives of the consumer in relation to the financial product or service and applies all the way through the customer journey and life cycle of the product. Again, it means the customer needs to have the right information at the right time to take responsibility for their decisions.

Required Outcomes

We've covered the overarching principle of the duty, and the cross-cutting rules that apply, so now it's time to look at what exactly the FCA means by 'good customer outcomes'?

Four outcomes

1. Design of products and services
2. Price and value
3. Consumer understanding
4. Consumer support

These four broad headings have different requirements depending on whether your firm is considered a manufacturer (broadly, product providers) and distributors (broadly, advisers). Business models will vary, but if your relationship with a product provider or a platform involves any words such as design, influence, create, develop, manage or bespoke then you are likely to be a co-manufacturer and will have extra responsibilities.

Note on vulnerable customers

The FCA wants you to be particularly aware of the needs of customers in vulnerable circumstances. You can read the guidance for firms on the fair treatment of vulnerable customers here.

1

Products and services

The key concept here is showing your client segmentation and demonstrating how your target market is specified, in what the FCA refers to as 'the degree of granularity necessary'. The FCA expects you to take time to understand what consumers may need from a product or service, and to be able to show the process you use, as well as the ways consumer needs can evolve and how that's built into the service offering.

Firms should understand the products or services they distribute, have distribution arrangements in place for each product or service they offer, and identify or create a strategy around this. In addition, for firms distributing products or services that were not created by a firm subject to the rules for manufacturers, they must comply with the products and services outcome.

Practical help – segmentation

Financial Advisers often tell us that one of their most compelling challenges is how to service clients as individually and personally as possible – in a way that's scalable and financially viable for their business.

With consultants NextWealth we have produced a practical guide which shows how segmentation has evolved – from focusing on level of assets to considering other factors, such as life stage and occupation. Written with the implementation of the Consumer Duty in mind, it shows how to implement segmentation as part of a centralised investment proposition and explores the potential benefits of segmentation and the questions you could be asking as you develop your approach.

Throughout, there are insights on segmentation trends, insights from Financial Advisers and tips from those who have done it themselves. The guide is available here.

Once you've identified your target markets, the next step is to demonstrate how you check that your services and products are, and continue to be, appropriate. This would include any comparison and benchmarking services you use to do this. In particular, the FCA wants to see how you consider any clients that might find themselves in vulnerable circumstances, either temporarily or on an ongoing basis.

QUESTIONS YOU SHOULD BE ABLE TO ANSWER

- Have you defined your target market at an appropriate level of granularity?
- Are you happy that your products and services are well designed to meet the needs of consumers in the target market and perform as expected? Have you tested that?
- How have you identified if the product or service has features that could risk harm for groups of customers with characteristics of vulnerability. What are you doing about that?
- How are you monitoring that products and services are being correctly distributed to the target market?
- What data and management information are you using to monitor whether products and services continue to meet the needs of customers and contribute to good consumer outcomes? What action is being taken as a result?
- If you're planning to withdraw a product or service, is there any foreseeable harm and what are you planning to do about it?

As an advice firm, you will be required to work more closely with product providers (manufacturers) and supply them with the information they need to meet their own responsibilities. And if you spot an issue with another firm breaching the duty, you have an obligation under the FCA's Senior Managers and Certification Regime to report this.

2

Price and value

In order to assess if a product or service provides value, you must consider at least the following:

- the nature of the product or service, including the benefits that will be provided or may reasonably be expected, and their qualities
- any limitations that are part of the product or service, such as limitations on scope of cover for insurance products, and
- the expected total price customers will pay, including all applicable fees and charges over the lifetime of the relationship between customers and firm.

This is an outcome that the FCA is focusing on particularly closely. You need to demonstrate your products and services offer fair value. This includes all relevant costs and charges the client is likely to incur. You also have to show how fair value is being monitored and reviewed on an ongoing basis and what action is being taken, if necessary. For example, have you benchmarked price and value against similar services to yours?

This doesn't mean you have to offer the cheapest service or recommend the cheapest products. If you offer something your clients value, understand and are willing to pay more for – and can clearly demonstrate this – then you're meeting the requirements of the duty. But service in itself is not a differentiator.

Financial Advisers are expected to ensure value for money for their own adviser charges, and also the total charge their clients are paying. All firms need to develop a process to achieve this, including collecting the required cost and charges information from providers.

QUESTIONS YOU SHOULD BE ABLE TO ANSWER

- Can you clearly illustrate how any product or service you provide offers fair value?
- Can you demonstrate that the costs associated with the products and services you offer are clear to the client?
- How do you monitor the impact of different pricing on different clients?
- In what ways do you review the price and value of the products and services you provide?

3

Consumer understanding

The FCA renamed this outcome 'consumer understanding', rather than 'consumer communications'. This is to emphasise it isn't just about disclosure and documentation, but the whole process of engagement throughout the client journey. The FCA wants firms to support their customers' understanding by ensuring that communications meet the information needs, are likely to be understood by the intended customers, and equip them to make decisions that are effective, timely and properly informed.

It's not enough to have a one-size-fits-all approach. Firms need to make sure communications take into account the characteristics of the customers intended to receive them. Things you need to be especially aware of include any characteristics of vulnerability, the complexity of products, the communication channel used, and the role of the firm in the process. If your business model involves interacting directly with a customer on a one-to-one basis, and for the majority of Financial Advisers it will, the most immediate way to get feedback is to ask them if they understand the information and have any further questions.

QUESTIONS YOU SHOULD BE ABLE TO ANSWER

- Do people have the right information at the right time to make decisions?
- How are you testing your communications, especially when a decision has to be made?
- If your value for money calculations show that your clients really understand they're paying extra for your particular expertise, qualifications and skills, can you provide evidence of that?
- Do your communications encourage consumers to share information about any needs they may have?
- And if you use a range of communication channels, are these equally effective, or are clients who use the phone getting a better service than those who email, or vice versa?

4

Consumer support

The FCA wants firms to provide a level of support that meets consumers' needs throughout their relationship with the firm. Consumers should be able to understand the benefits of their products and services and be supported when they want to pursue their financial objectives. So firms have to ensure that they design and deliver support that meets the needs of customers. This includes those with characteristics of vulnerability (bearing in mind that people can move in and out of vulnerable circumstances).

Can customers use their products as reasonably anticipated? Appropriate friction in customer journeys (such as an option to get more information should the customer wish) should be included to mitigate the risk of harm and give customers sufficient opportunity to understand and assess their options. This needs to be balanced against creating unreasonable barriers (including unreasonable additional costs such as switching fees) during the lifecycle of a product or service. All of these areas must be monitored throughout the lifecycle of the product or service, and a process put in place to address any issues that arise as a result of the monitoring.

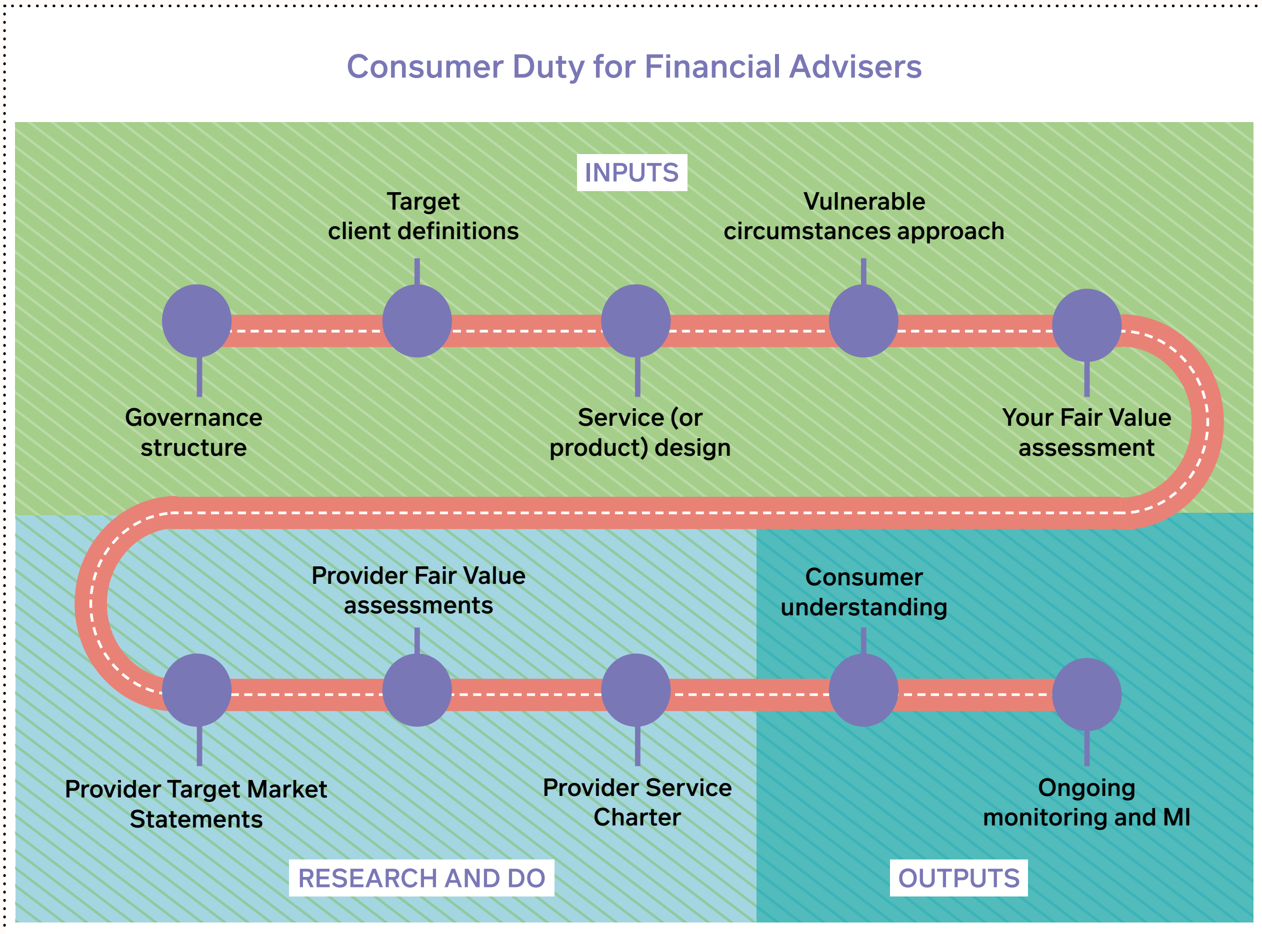
Is your support meeting clients' needs throughout the process? The FCA has stressed that you should be able to demonstrate how the quality of post-sale or ongoing support is as good as your new client process. For both providers and Financial Advisers this means it should be at least as easy to switch or leave your products or discontinue your services as it was to take them on in the first place. If you pride yourself on your client retention and ongoing service then this is a particularly important area to evidence.

QUESTIONS YOU SHOULD BE ABLE TO ANSWER

- Are you effective at meeting customer needs regardless of the method of contact used and do you test this?
- What assessment has the firm made about whether its customer support is meeting the needs of those customers with characteristics of vulnerability and how is this being measured?
- Is it as easy to switch or leave your firm's products and services as it is to buy them in the first place?
- How have you satisfied yourself that the quality of any post-sale support is as good as the pre-sale support?
- What information are you using to monitor the impact your consumer support is having on customer outcomes and what are you doing with the results?
- Are you monitoring outsourced or third-party service providers, and are you confident their services meet the consumer support standards?

A plan for best practice

Here is an example of how a best practice plan for the Consumer Duty might look. Working through these various stages should give you the key elements for complying with the duty.



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