



A New Consumer Duty – Response from New City Agenda

Key Recommendations

- The new Consumer Duty should require firms to act in the best interests of retail clients.
- The cross-cutting rules must require firms to prevent harm and help customers to pursue their financial objectives.
- An additional outcome should be introduced that where retail clients, including SMEs, have suffered harm firms should be required to provide redress promptly and efficiently.
- It is critical that the FCA introduces a Private Right of Action for the Consumer Duty, the cross-cutting rules and the five outcomes. The PROA should also be introduced for the existing Principles for Business.
- The Consumer Duty should have a wide scope and apply to unregulated activities provided by regulated firms.
- The FCA should not reintroduce the concept of the “reasonable expectations” of consumers when setting the standards firms need to meet to comply with the Consumer Duty. This concept is vague and impossible to quantify, helped cause the Equitable Life scandal and would damage the prospects of the Consumer Duty leading to the necessary improvements.
- The FCA must ensure that alongside the new Consumer Duty it puts in place much stronger incentives for firms and senior managers to comply.
- Accountability for complying with the Consumer Duty should be set at senior manager level, triggering the provisions of the Senior Managers and Certification Regime (SMCR).
- Senior managers must be subject to enforcement action for breaches of the Consumer Duty.

To maximise the chances of these proposals advancing the consumer protection and competition objectives, the FCA should:

- Understand why previous attempts to move to outcomes-focused regulation were not successful and use the lessons learned to promote the success of the new Consumer Duty
- Measure and assess the levels of consumer harm across different sectors
- Set and measure the outcomes the FCA expects to be achieved for consumers
- Understand how behavioural biases within firms and regulators could influence the implementation and responses to the new Consumer Duty.
- Use the FCA’s full suite of powers to strengthen the incentives of firms and senior managers to comply with the new Consumer Duty and reduce the level of harm suffered by consumers
- Conduct proper independent evaluation of the introduction of the new Consumer Duty and whether it has led to a reduction in harm.

Lord Sharkey, Chair, New City Agenda

Helping shape financial policy

New City Agenda Ltd, 20-22 Wenlock Road, London N1 7GU

T: +44 (0)20 3397 7875 www.newcityagenda.co.uk Email: Dominic.Lindley@newcityagenda.co.uk



Executive Summary

The FCA should introduce a new Consumer Duty which should make it clear that firms should act in the best interests of their customers. This would encourage firms to identify and prevent harm before it occurs which is in line with the stated aim of the FCA's Mission. This would help support a change of culture within the industry and provide a better balance between the responsibilities of consumers and firms.

We believe that it is critical that we give consumers a Private Right of Action (PROA) for the Consumer Duty, the cross-cutting rules and the five outcomes as well as the existing Principles. The key advantage of giving consumers a Private Right of Action for a breach of the Consumer Duty and the FCA principles is that it would enable the FCA to utilise its powers under Section 404 of FSMA to require firms to pay redress to consumers where there has been the breach of the New Duty or a Principle. It is vital that the FCA introduces a PROA for the Consumer Duty as a failure to do would weaken the incentives on firms to prevent harm or comply with the Duty. If a PROA is not introduced then what the FCA is proposing would not amount to a legal duty of care.

The Consumer Duty must have a wide scope and apply to a firm's dealings with individual consumers as well as SMEs. The Consumer Duty should apply where a firm's actions (or inaction) could cause harm to consumers. It must apply even where the firm does not have a direct relationship with the customer involved such as where a firm is the recipient bank for an Authorised Push Payment scam. In this consultation, the FCA haven't asked the question as to whether the Consumer Duty should apply to the unregulated activities of regulated firms. We recommend that the requirement for firms to take all reasonable steps to prevent foreseeable harm to customers and the requirement to act in good faith should apply to the unregulated activities of regulated firms. This would particularly benefit SMEs where some of the activities such as lending are currently outside the regulatory perimeter.

The FCA/FSA has promised a shift to "outcomes-focussed" regulation many times in the past and this new attempt through the Consumer Duty would benefit from an honest assessment of why previous attempts have not led to the desired reduction in harm suffered by consumers.

The Consumer Duty must ensure that firms are proactive in preventing harm to consumers and deliver additional protection to vulnerable customers. Where harm has been caused it should help consumers get redress. It must stop firms from hitting their customers with excessive charges or taking advantage of consumer inertia. It should halt the trend towards tick-box regulation by setting an over-riding test for firms to act in the best interests of their customers.

The FCA must ensure that firms are acting in the best interests of their customers at every phase of the customer journey – from how they design and sell products to how they deal with complaints and requests to switch.

For the wording of the Consumer Duty, we believe that requiring firms to act in the best interests of retail clients will be more proactive and lead to better results. For the cross-cutting rules we think changing the wording by requiring firms to "prevent" foreseeable harm and "help" customers pursue their financial objectives would help ensure that firms are more proactive in achieving these goals. To help ensure that where harm has been caused, consumers receive proper redress, the FCA should add an extra outcome for redress to be provided "promptly and efficiently".

Helping shape financial policy



Our recommendations for the wording of the Consumer Duty, Cross-cutting rules and Five Outcomes are:

Consumer Duty

- A firm must act in the best interests of retail clients

Cross-cutting rules

- Take all reasonable steps to **prevent foreseeable harm** to customers.
- Take all reasonable steps to **help customers** to pursue their financial objectives.
- Act in good faith.

Five Outcomes

- 1. **Communications** are understandable by consumers and equip them to make effective, timely and properly informed decisions about financial products and services.
- 2. **Products and Services** are specifically designed to meet the needs of consumers, and sold to those whose needs they meet.
- 3. **Customer Service** meets the needs of consumers, enabling them to realise the benefits of products and services and act in their interests without undue hindrance.
- 4. The **price** of products and services represents fair **value** for consumers.
- 5. When retail clients, including SMEs, have suffered harm they receive **redress** promptly and efficiently.

The FCA should not reintroduce the concept of the “reasonable expectations” of consumers when setting the standards firms need to meet to comply with the Consumer Duty. We believe that this would be extremely damaging to the prospects of the Consumer Duty leading to a reduction in harm. This concept of “reasonable expectations” is vague, lacking in clarity and was key in causing the Equitable Life scandal. It will be impossible to measure what the “reasonable expectations” of consumers were in any particular case and raises other awkward questions like whether standards can be low if consumers have low expectations. When the Government proposed reintroducing the concept of “reasonable expectations” in the 2012 Financial Services Bill, the Joint Committee described it as “problematic” and concluded that its reintroduction would be “unwise”. The Committee said that the concept of “reasonable expectations” would make it difficult for the regulator to be clear on the meaning of its duties, and near to impossible for consumers and Parliament to hold the [regulator] to account for its actions.

The consultation paper seems to assume a simple relationship between the introduction of a New Consumer Duty and firms automatically taking it into account and having a “stronger focus on customers’ interests and outcomes”. Without stronger action, the FCA risks repeating the mistakes of the Treating Customers Fairly initiative where it delegated to senior managers the task of defining what TCF meant but did not put in place strong enough incentives for firms to do so in a pro-consumer way.

The FCA must ensure that alongside the new Consumer Duty it puts in place much stronger incentives for firms and senior managers to comply. Accountability for complying with the Consumer Duty should

Helping shape financial policy

New City Agenda Ltd, 20-22 Wenlock Road, London N1 7GU

T: +44 (0)20 3397 7875 www.newcityagenda.co.uk Email: Dominic.Lindley@newcityagenda.co.uk



be set at senior manager level, triggering the provisions of the Senior Managers and Certification Regime (SMCR). This would lead to a defined responsibility under the SMCR and it is very important that executives should be subject to enforcement action in the event of any breaches and harm suffered by consumers. The FCA must ensure that it has a clearer understanding of what measures would act as an effective deterrent across different sizes and types of firms.

To maximise the chances of these proposals advancing the consumer protection and competition objectives, the FCA should:

- Understand why previous attempts to move to outcomes-focussed regulation were not successful and use the lessons learned to promote the success of the new Consumer Duty
- Measure and assess the levels of consumer harm across different sectors
- Set and measure the outcomes the FCA expects to be achieved for consumers
- Understand how behavioural biases within firms and regulators could influence the implementation and responses to the new Consumer Duty.
- Use the FCA's full suite of powers to strengthen the incentives of firms and senior managers to comply with the new Consumer Duty and reduce the level of harm suffered by consumers
- Conduct proper independent evaluation of the introduction of the new Consumer Duty and whether it has led to a reduction in harm.

Q1: What are your views on the consumer harms that the Consumer Duty would seek to address, and/or the wider context in which it is proposed?

There is clearly a need for significant improvements to reduce the harm suffered by consumers in the financial services market.

Recent examples of misbehaviour include the banks' response to the Authorised Push Payment fraud, inadequate assessment of affordability by payday lenders, poor advice about Defined Benefit pension transfers, the scandal in the Woodford Investment Management, sales of risky investment products on the boundary of the FCA's perimeter. In savings, banks leave customers in "obsolete" savings accounts paying minimal rates of interest. Peer to Peer lending platforms advertise excessively optimistic potential returns and make unjustified claims about safety and security. People have lost their life savings.

Loyal general insurance customers who have been with the same firm for 5 years can pay 70% more than a new customer. The media highlighted cases like Elsie, a 94 year old paying £1,280 a year for home insurance when a fair price was £118 a year. Combined with pricing practices in other sectors FCA Consumer Panel research found that some consumers could be incurring loyalty penalties in excess of 5% of annual income, and it is not impossible to imagine that for some consumers these costs are as high as 10% of their income.¹

At retirement, pension companies offered their loyal customers annuity rates which could be 15% below the market best rates. They also failed to offer enhanced annuities to their customers meaning

¹ https://www.fs-cp.org.uk/sites/default/files/automatic_upgrades_position_paper.pdf

that people with health conditions can miss out on higher rates. Finally, some mortgage firms keep captive customers on high SVRs and fail to offer them the ability to move to cheaper fixed rates.

Since 2000, New City Agenda calculate that the UK's retail banks have paid over £63 billion in fines and redress payments.² On top of this there will be billions of pounds of harm caused to consumers for which they have not received redress.

In our view, when considering the action required it is helpful to classify the consumer harm into three main categories:

- The harm was not identified by firms, civil society or the FCA.
- The harm and potential for harm was identified by firms, civil society or whistleblowers but the FCA failed to listen or absorb the information and intelligence provided.
- The harm and potential for harm was identified by the FCA but the action taken was not strong or proactive enough to prevent the harm or secure redress for consumers.

In the future, if the new Consumer Duty is successful in improving outcomes then we would expect significantly less harm in the second and third categories. If the right incentives are put in place to accompany it then the Consumer Duty should be successful in encouraging all to identify harm (and the potential for harm) to consumers and when accompanied by strong, open and proactive regulation should reduce the extent of harm occurring.

Previous attempts to introduce “outcomes” focussed regulation

The promise to focus on the outcomes for consumers is welcome, but is one that has been made by senior executives at the regulator many times over the past 20 years since the introduction of FSMA 2000. There have also been various attempts over the years to measure the outcomes received by consumers and the impact of FCA regulation. These attempts to define outcomes and performance frameworks for the FCA have suffered from an inadequate focus of FCA senior management and the Board, combined with a constant cycle of transformation and reinvention. When proposing interventions in the past the FCA has also conducted inadequate cost-benefit analysis by only conducting a cost-benefit analysis for a policy it has already chosen, rather than the range of potential options which exist. This could arise from the way the FCA chooses to interpret Section 138I of FSMA. The FCA has stated that it will only conduct cost benefit analyses for the interventions it proposes and it is “not required to assess a proposed intervention against other possible interventions”.³ The FCA's approach seems to be in direct contravention of the Government's guidelines on the use of appraisal and evaluation including cost-benefit analysis. This states that a short-list of options should be created which should “cover a wide range of potential action” and that the “costs and benefits of [these options] should be valued”.⁴

There is also a lack of independent evaluation and the FCA has not established an Independent Evaluation Office like the Bank of England. Any independent evaluation which does occur can come

² <https://newcityagenda.co.uk/the-top-10-retail-banking-scandals-50-billion-reasons-why-shareholders-must-play-a-greater-role-in-changing-bank-culture/>

³ FCA (2016), CP 16/20, Page 139

⁴ HM Treasury, The Green Book, Appraisal and Evaluation in Central Government



many years after the event through an Independent Reviewer appointed by the Treasury. The FCA is also vulnerable to adaptive processes where instead of accurately measuring outcomes and detriment it uses the data it gathers to justify why no further action needs to be taken. For example, for mortgage prisoners the FCA placed great weight on its claim that 55,000 customers who couldn't switch were only paying rates 0.4% higher than other similar customers in the active market. This was a comparison based on Standard Variable Rates and ignored the fact that customers in the vast majority of mortgage customers in the active market could access much lower fixed-rate deals.

The difficulties in changing the culture of the regulator to focus more on outcomes and being more proactive have been well documented in a number of reports including *New City Agenda's Cultural change in the FCA, PRA and Bank of England: Practising what they preach?*⁵

The consultation paper also seems to assume a simple relationship between the introduction of a New Consumer Duty and firms automatically taking it into account and having a "stronger focus on customers' interests and outcomes". As it introduces the new Consumer Duty, it must be accompanied by a clear understanding of how firms and senior executives are taking decisions and for action by the FCA to be strong, open and proactive to strengthen the incentives for firms to prevent harm from occurring and comply with the new Consumer Duty.

We believe the following pieces of work would help the FCA achieve the desired change:

- An honest assessment of what the barriers were which caused the previous statements of a renewed focus on outcomes to fail to be translated into improvements for consumers?
- A renewed focus on what are the key incentives faced by senior managers and firms to deliver good outcomes for consumers and how these incentives can be strengthened to lead to improvements for consumers.
- A review of several business areas where there has been an insufficient focus on outcomes for consumers by the FCA and how the approach promised in this consultation paper would have led to different action by the regulator and different outcomes received by consumers.⁶

Attempts to introduce outcomes-focussed regulation – what the FSA and FCA have said about it in the past

"We want to bring about an environment where the consumer harms described above do not occur in the first place, because firms are consistently placing their customers' interests at the heart of their businesses. We want firms to extend their focus beyond ensuring narrow compliance with specific rules, to also focus on delivering good outcomes for consumers. While firms must continue to comply with our rules, we are increasingly looking for senior management to think proactively about the intent behind our rules, and the impact of their actions on their customers." – FCA, A New Consumer Duty, Para 2.21, 2021

⁵ New City Agenda (2016), *Cultural change in the FCA, PRA and Bank of England: Practising what they preach?*, <https://newcityagenda.co.uk/wp-content/uploads/2016/10/NCA-Cultural-Change-in-regulators-report.pdf>

⁶ For example, if the Consumer Duty had been in place, the FCA should consider how FCA action (and the outcomes received by consumers) would have been different in important areas like Retirement Outcomes, Mortgage Prisoners, Mini-bonds/London Capital & Finance etc.

Helping shape financial policy

New City Agenda Ltd, 20-22 Wenlock Road, London N1 7GU

T: +44 (0)20 3397 7875 www.newcityagenda.co.uk Email: Dominic.Lindley@newcityagenda.co.uk



“the content of those discussions will also change, away from investigation of whether evidence exists to demonstrate compliance with specific rules to discussion of broader issues and of desired outcomes: in short, a move away from what is normally characterised as “box ticking” – the comfort zone for both regulator and compliance functions.” Sir Callum McCarthy, 2006⁷

“Through our Treating Customers Fairly initiative we have focused on giving the requirement to treat retail customers fairly renewed emphasis. Our aim has been to see a stepchange in the behaviour of the financial services sector and therefore to deliver improved outcomes for retail consumers. The outcomes are summarised below:

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.

Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.

Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.

Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances.

Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.

Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.” – Treating Customers Fairly, Towards Fair Outcomes for Consumers, 2006⁸

“Our outcomes-focused philosophy requires supervisors to judge firms on the likely consequences of their decisions. This means the proportion of our time spent looking at systems and controls will diminish relative to our focus on assessing the outcomes of a firm’s actions. This will necessarily be controversial at times, as our view and the firm’s view will not always coincide. This divergence of judgement can normally be resolved, but the FSA recognises that this new approach may create tensions and will certainly no longer be seen as light touch! To enable us to deliver on this approach we have equipped ourselves both to forecast and test outcomes. This capacity is needed to enable us to effectively make judgements on the judgements firms are making.”⁹ – Hector Sants, 2009

⁷ Sir Callum McCarthy (2006), Principles-based regulation – what does it mean for the industry?

⁸ <https://www.fca.org.uk/publication/archive/fsa-tcf-towards.pdf> Para 1.2

⁹

https://webarchive.nationalarchives.gov.uk/20120904112130/http://www.fsa.gov.uk/library/communication/speeches/2009/1109_hs.shtml Hector Sants, 2009

Helping shape financial policy

New City Agenda Ltd, 20-22 Wenlock Road, London N1 7GU

T: +44 (0)20 3397 7875 www.newcityagenda.co.uk Email: Dominic.Lindley@newcityagenda.co.uk



Extract from *Journey to the FCA* on the measuring performance against the FCA’s statutory objectives – outcomes and outcomes indicators

In its *Journey to the FCA* document the FCA set out a series of “outcome indicators” shown in the table below which it would monitor.¹⁰ This is an approach which the FSA took many times in the past, for example through its Outcomes Performance Framework in 2007.¹¹ However, once the difficulties of doing this becomes apparent regulators normally fall back on not measuring performance, listing a series of general outcomes which are not measured or an adaptive process where the FCA reports a small set of outcomes which demonstrate progress whilst ignoring other indicators or examples which are moving in the wrong direction. Although the FCA claims to have an “outcomes-based” performance framework, it does not provide any clear detail about how it is measuring the vast majority of the outcomes outlined in its annual report (although there was a welcome commitment to measuring and setting more outcomes in the latest report, this type of commitment has been made many times before).

¹⁰ <https://www.fca.org.uk/publication/corporate/fsa-journey-to-the-fca.pdf>

¹¹

https://webarchive.nationalarchives.gov.uk/20091203183231/http://www.fsa.gov.uk/pubs/other/evaluate_OPR.pdf



FCA: Measuring performance against the statutory objectives

Statutory objectives	Ensuring that financial services markets function well					
	Securing an appropriate degree of protection for consumers		Promoting effective competition in the interests of consumers		Protecting and enhancing the integrity of the UK financial system	
Outcomes	Consumers have access to fair products and services, which deliver what they promise	Consumers can be confident that firms treat them fairly and fix problems promptly	Competition contributes to improved consumer outcomes	Firms compete on clear costs and consumers have the information they need	Consumers can trust firms to be fit and proper and for financial markets to be clean	A respected regulatory system that lets good firms know where they stand
Outcomes indicators	Fair products and services	Building trust and engagement	Value for money products and services	Competitive markets	Clean regulated markets	Attractiveness of market
	Improved consumer experience	Effective remedies	Getting better service	Clear and useful information	Low financial crime	Respected, joined-up regulation

Q2: What are your views on the proposed structure of the Consumer Duty, with its high-level Principle, Cross-cutting Rules and the Four Outcomes?

We agree with the proposed structure only on the basis that a private right of action is granted to consumers for breaches of the high-level Consumer Duty, the principles, the cross-cutting rules and also the four outcomes. Absent this right we disagree with the proposed structure.

Q3: Do you agree or have any comments about our intention to apply the Consumer Duty to firms' dealings with retail clients as defined in the FCA Handbook? In the context of regulated activities, are there any other consumers to whom the Duty should relate?

Q4: Do you agree or have any comments about our intention to apply the Consumer Duty to all firms engaging in regulated activities across the retail distribution chain, including where they do not have a direct customer relationship with the 'end-user' of their product or service?

The Consumer Duty must have a wide scope and apply to a firm's dealings with individual consumers as well as SMEs. It is also vital that it applies to all firms engaging in regulated activities across the distribution chain, including where they do not have a direct customer relationship. This would mean,

Helping shape financial policy

New City Agenda Ltd, 20-22 Wenlock Road, London N1 7GU

T: +44 (0)20 3397 7875 www.newcityagenda.co.uk Email: Dominic.Lindley@newcityagenda.co.uk



for example, that the Consumer Duty should also apply to firms involved in product design and product manufacturing, even if they are not involved directly in selling the product to consumers. The Consumer Duty should also apply in circumstances where a regulated firm approves a financial promotion, even if that firm is then not involved in selling the product to consumers.

It is also important that the Consumer Duty is applied to “potential customers” so that action can be taken against a regulated firm if they deny consumers access to financial products.

Finally, it is important that the Consumer Duty applies to occasions where a firm’s actions (or inaction) could have an impact on the outcome received by a consumer. The specific example we believe should be referenced and included would be the action of a ‘beneficiary’ or ‘recipient’ bank in a case of an Authorised Push Payment fraud.

It is not clear whether the FCA has made a decision to apply the Consumer Duty to unregulated activities of regulated firms and the question is not asked directly in this consultation. We would support a similar approach to the Conduct Rules where the rules apply when individuals are undertaking functions relating to the carrying on of activities (whether regulated or not) by their firm. The FCA said at the time that this would play an important role in driving up standards of conduct.¹² We recommend that the requirement for firms to take all reasonable steps to prevent foreseeable harm to customers and the requirement to act in good faith should apply to the unregulated activities of regulated firms. The exact requirements specified in the cross-cutting rules could differ for the unregulated activities of regulated firms, but applying the high level requirements could help mitigate risks to consumers from activities outside the perimeter. This would particularly benefit SMEs where some of the activities such as lending are currently outside the regulatory perimeter.

Q5: What are your views on the options proposed for the drafting of the Consumer Principle? Do you consider there are alternative formulations that would better reflect the strong proactive focus on consumer interests and consumer outcomes we want to achieve?

Option 1: ‘A firm must act to deliver good outcomes for retail clients’

Option 2: ‘A firm must act in the best interests of retail clients’

Of the options presented we prefer Option 2. To require a firm to “act in the best interests of retail clients” is more proactive and sets a higher standard. Requiring a firm just to act to deliver “good outcomes” risks firms just investing significant resources in trying to justify why their existing conduct already delivers “good outcomes” and so would not lead to the significant improvements which are needed.

Q6: Do you agree that these are the right areas of focus for Cross-cutting Rules which develop and amplify the Consumer Principle’s high-level expectations?

Q7: Do you agree with these early-stage indications of what the Cross-cutting Rules should require?

Q8: To what extent would these proposals, in conjunction with our Vulnerability Guidance, enhance firms’ focus on appropriate levels of care for vulnerable consumers?

¹² <https://www.fca.org.uk/publication/corporate/fca-report-further-investigation-rbs-grg.pdf> Page 11



We agree that firms should avoid causing foreseeable harm to customers and also recommend that the wording of this cross-cutting rule should be expanded to require firms to be proactive in preventing “foreseeable harm”. We are concerned that the current wording which just requires firms to “avoid causing” harm could allow firms to justify inaction where they did not directly cause the harm, but could have taken action to prevent it from happening.

The second cross cutting rule which the FCA proposes to be for firms to “Take all reasonable steps to enable customers to pursue their financial objectives” risks firms placing too much emphasis on the responsibility of customers for taking decisions. Given the vulnerabilities and lack of capability which exist among consumers and SMEs and the imbalance of bargaining power, knowledge and expertise with financial services firms we do not think this requires firms to be proactive enough. Changing “enable” to “help” would be an improvement.

We support the draft for the third cross-cutting rule for firms to “act in good faith”.

Therefore our proposal for the three cross-cutting rules is:

- Take all reasonable steps to prevent foreseeable harm to customers.
- Take all reasonable steps to help customers to pursue their financial objectives.
- Act in good faith.

The concept of reasonable expectations of consumers

The FCA proposes to reintroduce the concept of the “reasonable expectation of consumers” into the regulatory framework. The FCA says that “What the firm needs to do to comply with the Consumer Duty will vary depending on what a reasonable consumer would expect.” We believe that this risks reintroducing the discredited concept of Policyholders Reasonable Expectations and repeating all of the problems which occurred in the 1980s and 90s, especially those around the failure of Equitable Life. The concept of Policyholders Reasonable Expectations was “An expression derived from the words ‘the reasonable expectations of policy holders or potential policy holders’ in the statutory grounds for the use of intervention powers by the prudential regulators, under section 37(2) of the Insurance Companies Act 1982”. This concept was described by Sir Howard Davies in 2001 as having a “chequered history” and to be “lacking in clarity and definition” and was described by the Treasury Minister as “nebulous”.¹³ Problems around agreeing and defining what was meant by “reasonable expectations” were one of the key issues which led to the failure of Equitable Life. The concept was removed from the FSA’s regulatory framework in 2001/02 and replaced with the concept of Treating Customers Fairly. Treating Customers Fairly was seen as a positive obligation and no longer required those considering regulatory intervention to demonstrate that firms had not fulfilled the “reasonable expectation” of consumers/policyholders.

When the concept of “Reasonable Expectations” was proposed to be reintroduced in the 2012 Draft Financial Services Bill, the report of the Joint Committee on the Bill described the phrase as “problematic” and said that it was unwise “for the Treasury to revive it in new legislation”. We have reproduced an excerpt from the Report of the Joint Committee below and would note the view of the FSA that the phrase “gave rise to a lack of clarity as to how those expectations were formed, what the

¹³ <https://publications.parliament.uk/pa/cm200102/cmselect/cmtreasy/317/1103006.htm>



substance of them was, and what actions the firm (and the regulator) should take in relation to them.” We believe all of these objections which the FSA thought gave rise to a lack of clarity also arise in using the term “reasonable expectation of consumers” to define the action necessary under the Consumer Duty. There will be questions about whether it means the “reasonable expectation” of the “average” consumer or the particular consumer in each case? What if different consumers have different “expectations” which could all be seen as being “reasonable” in their particular circumstances? Would this mean that they should be treated differently? What if consumers have low “expectations” and this is used by firms and the FCA to justify a lack of action necessary after the introduction of the new Consumer Duty?

It will be impossible in any case to measure accurately (with hindsight) what the “reasonable expectation of consumers” was in any particular case and will lead to further questions and delay in individual cases and could make the FCA very reluctant to take action under the new Consumer Duty as it would involve long and protracted debate about what this term means. We recommend that the term “reasonable expectation of consumers” should not appear in the explanation or rules and guidance concerning the implementation of the Consumer Duty.

Extract from the Joint Committee Report into the Financial Services Bill 2012 concerning the Committee’s conclusions on the ‘reasonable expectations’ of policyholders

The term ‘reasonable expectations’ is problematic. It has a legislative precedent in the (now repealed) Insurance Companies Act 1982. The FSA told us that under that Act the phrase “gave rise to a lack of clarity as to how those expectations were formed, what the substance of them was, and what actions the firm (and the regulator) should take in relation to them”. Indeed, much of the Equitable Life litigation revolved around the problems of defining the term. The FSA has said that the concept underlying ‘reasonable expectations’— but not the phrase—has since been subsumed within the FSA’s Principle 6 (Treating Customers Fairly Principle) and its rules on with profits policies.

In the context of the draft Financial Services Bill, the FSA told us that although it supported the general policy aim, reintroducing the phrase ‘reasonable expectations’ risked “perpetuating this lack of clarity” and would be “an unfortunate retrograde step”. Sir Mervyn King warned the House of Commons Treasury Committee in June that the term was “almost impossible to define for the regulator” and risked “leaving the regulator open to ex post judgements by others in court as to what it should and should not have done”.¹⁴

There is legal uncertainty regarding the definition of the “reasonable expectations” of policyholders. Using a phrase of this kind makes it difficult for the PRA to be clear on the meaning of its duties, and near to impossible for consumers and Parliament to hold the PRA to account for its actions. The phrase has been shown to be problematic in the past: it is unwise for the Treasury to revive it in new legislation and thereby risk the same difficulties recurring. The PRA should be responsible for ensuring that with-profits consumers are treated fairly, but the Treasury must find a way to redraft the Bill to achieve this end without using the problematic phrase “reasonable expectations”. The PRA should be given an explicit

¹⁴ https://www.ius.uzh.ch/dam/jcr:00000000-5906-882a-0000-0000124b30ba/joint_committe_report.pdf
Para 88 and 89



duty to consult the FCA, as the consumer expert, on matters affecting with-profits consumers.

Q9: What are your views on whether Principles 6 or 7, and/ or the TCF Outcomes should be disapplied where the Consumer Duty applies? Do you foresee any practical difficulties with either retaining these, or with disapplying them?

Q10: Do you have views on how we should treat existing Handbook material that relates to Principles 6 or 7, in the event that we introduce a Consumer Duty?

We think immediately disapplying Principles 6 and 7 and the TCF outcomes would be problematic. It would create uncertainty for consumers and firms and would also require a wholesale re-write of the Handbook as there are a significant number of references to the Principles which would need to be changed. This could significantly delay the date on which the new Consumer Duty comes into force. We would support a gradual review of the Handbook material combined with the FCA being clearer with firms and consumers as part of its move to “outcomes-based” regulation regarding what the outcomes it expects firms to achieve and how they should be measured.

To minimise the potential for any legal conflict and minimise any practical difficulty it would be vital for the FCA to also apply a Private Right of Action to the existing Principles. As we note below, we view it as unlikely that many individual consumers would make use of the PROA, but it would allow the FCA to impose a redress scheme under Section 404 of FSMA for a breach of a Principle.

Q11: What are your views on the extent to which these proposals, as a whole, would advance the FCA’s consumer protection and competition objectives?

As we note above, the consultation paper seems to assume a simple relationship between the introduction of a New Consumer Duty and firms automatically taking it into account and having a “stronger focus on customers’ interests and outcomes”. Without stronger action, the FCA risks repeating the mistakes of the Treating Customers Fairly initiative where it delegated to senior managers the task of defining what TCF meant but did not put in place strong enough incentives for firms to do so in a pro-consumer way.

The FCA will need to develop a clearer model for how these proposals will advance the FCA’s consumer protection and competition objectives and consider how this can be applied to different sizes and firms. It will also have to consider what factors currently influence the behaviour of people in firms who could prevent harm.¹⁵ For example, factors could include:

- Reward;
- Potential loss;
- Career risk;
- Competitive pressure;
- Peer pressure;

¹⁵ For example, see Lo, Andrew W., The Gordon Gekko Effect: The Role of Culture in the Financial Industry (2016). Economic Policy Review, Issue Aug, pp. 17-42, 2016, Available at SSRN: <https://ssrn.com/abstract=2828072>



- Internal / external challenge / voice of the customer;
- Self image;
- The Regulatory environment.

We don't think the FCA knows enough about what acts as an effective deterrent or what could prevent consumer harm.¹⁶ These factors will clearly be different across different sizes and types of firms as well as depending on the attitudes of those running the firm (and if they are large enough their compliance department). For example, if we take firms like a large high-street bank, they may respond to the Consumer Duty by introducing a complex suite of new Management Information to capture some of the outcomes. But this might all be displacement activity designed to justify why the "outcomes" already received by customers are already good enough and so no changes need to be made. The senior executives might not know or have the right incentives to know what was actually going on for its customers or what harm they were suffering. The attitude of senior executives could be similar to that described by Peter Vicary-Smith when he gave evidence to the Parliamentary Commission on Banking Standards:

One is that I think there was a genuine lack of understanding among some senior people within firms as to what principles-based regulation actually meant. I had a conversation, when it was introduced, with the deputy chief executive of one of the major banks, who said to me, "It is not going to make a blind bit of difference to what I do. I do not go into the bank in the morning in order to treat my customers unfairly."

If the FCA want senior managers to think creatively and put themselves in the shoes of their customers they are going to need to strengthen the incentives. This should mean that accountability for complying with the Consumer Duty should be set at senior manager level and that executives should be subject to enforcement action under the SMCR in the event of any breaches and harm suffered by consumers.

The FCA has devoted a welcome amount of resources to assessing and considering the behavioural biases of individual consumers and how this can drive their behaviour. The FCA has done very little to assess and consider the behavioural biases of senior managers within firms when deciding whether and how to comply with regulation and act to reduce harm for their customers.

Finally, as recommended by the New City Agenda report into the culture of regulators, the FCA will also need to understand the behavioural biases of the regulators' staff and senior executives and how these might influence the implementation and prospect for success from the Consumer Duty:

Understand regulators behavioural biases. The FCA had begun to undertake work examining how consumers behave. It needed to acknowledge that staff working in regulators could also be subject to behavioural biases. Just like we know that Doctors bias towards over-prescribing drugs, we might find that regulators have biases towards excessively complex regulation. This

¹⁶ For example, the Australian Securities and Investment Commission has published research which said "There is currently a dearth of knowledge and research as to what effectively deters corporate crime. Most deterrence research focuses on crimes against the person and property, not financial services or regulated industries." <https://download.asic.gov.au/media/4916053/18-325mr-deterrence-effects-of-enforceable-undertakings-on-financial-services-and-credit-providers.pdf>



might involve conducting a more thoughtful analysis of the behavioural biases which shape regulatory behaviour and suggesting some ‘nudges’ which might ensure that unhelpful biases do not take over.¹⁷

To maximise the chances of these proposals advancing the consumer protection and competition objectives, we believe the FCA should:

- Understand why previous attempts to move to outcomes-focused regulation were not successful and use the lessons learned to promote the success of the new Consumer Duty
- Measure and assess the levels of consumer harm across different sectors
- Set and measure the outcomes the FCA expects to be achieved for consumers
- Understand how behavioural biases within firms and regulators could influence the implementation and responses to the new Consumer Duty.
- Use the FCA’s full suite of powers to strengthen the incentives of firms and senior managers to comply with the new Consumer Duty and reduce the level of harm suffered by consumers
- Conduct proper independent evaluation of the introduction of the new Consumer Duty and whether it has led to a reduction in harm.

Q12: Do you agree that what we have proposed amounts to a duty of care? If not, what further measures would be needed? Do you think it should be labelled as a duty of care, and might there be upsides or downsides in doing so?

We believe that what is proposed will only amount to what could be labelled as a duty of care if it includes the Private Right of Action, enabling consumers to take action for any breaches.

General comments on The Four Outcomes

A missing outcome

We are concerned that the FCA has not included an outcome relating to redress. Across the 20 year history since the introduction of FSMA, where consumers have suffered harm, firms have often been in denial about the extent of misconduct and redress, have been slow to provide redress and put consumers through long and inefficient processes. We recommend that the FCA should add an extra outcome:

5. Redress: When retail clients, including SMEs, have suffered harm they receive redress promptly and efficiently.

To achieve this outcome we would expect the FCA to implement high-level rules and guidance requiring firms to:

- Assess whether harm has been caused to current and former customers.

¹⁷ New City Agenda (2016), Cultural change in the FCA, PRA & Bank of England: Practising what they preach?, Page 91



- Conduct root cause analysis to understand the causes of harm to current and former customers.
- Where it finds customers who have suffered harm but who have not complained conduct a proactive redress exercise.

Q13: What are your views on our proposals for the Communications outcome?

Q14: What impact do you think the proposals would have on consumer outcomes in this area?

We support the proposals for the Communications outcome with a small addition to require communications to be “understandable”. The focus of this new outcome should be to ensure that communications are understandable and that they help consumers compare products and take better decisions. The point about testing and refining communications is particularly important and although it has been made many times in the past by regulators it is usually not implemented in practice. To improve confidence that this testing is actually happening the FCA could collate and publish examples of good practice.

Q15: What are your views on our proposals for the Products and Services outcome?

Q16: What impact do you think the proposals would have on consumer outcomes in this area?

We support the proposals for the headline Product and Services outcome. However, we believe that the high level rules and guidance implemented under this outcome should include:

Requirements for firms to avoid excessively complex product ranges, such as those which exist in the savings account market where firms launch a complex range of savings accounts and cash ISAs which are used to price discriminate against inert and vulnerable customers.¹⁸ In this case each individual product is quite simple, but it is the complex product ranges which causes the harm to consumers.

Requirements for firms to automatically upgrade consumers into the best available product the firm currently offers. This would implement the recommendations of the Financial Services Consumer Panel for a new auto-upgrade rule which would require firms to move customers in poorly performing or poor value products onto better, comparable products offered by the same provider. This would help tackle the harm caused to customers where there is an existing deal available to other customers, but they are left where you are or where there is a product on more favourable terms, but they will be auto-renewed into a price greater than would be charged to new customers.

Requirements for firms to take into account principles of inclusive design. Firms need to bring in the consumer voice by engaging with consumers directly, including experts by experience of, for example, poverty and wider vulnerabilities. Fair by Design has produced a guide for inclusive design for firms.¹⁹

Q17: What are your views on our proposals for the Customer Service outcome?

Q18: What impact do you think the proposals would have on consumer outcomes in this area?

¹⁸ <https://www.fca.org.uk/publication/consultation/cp20-01.pdf>

¹⁹ <https://fairbydesign.com/wp-content/uploads/2021/01/Inclusive-Design-Firms-Guide-Final.pdf>



We support the proposals for the Customer Service outcome. It is important that this is implemented in a way which prevents firms from placing barriers in the way of consumers. For example, during the recent coronavirus pandemic some mortgage firms would initially only accept applications for payment holidays if consumers contacted them over the phone.

Q19: What are your views on our proposals for the Price and Value outcome?

Q20: What impact do you think the proposals would have on consumer outcomes in this area?

We support the proposals for the price and value outcome. It is important for the FCA to take action to achieve this outcome. For example, for years, consumers reaching retirement with some firms were offered annuities 10%-15% off the market best rates. Instead of solving this problem by requiring firms to offer reasonable value annuities the FSA/FCA followed an approach based on providing information and prompting consumers to shop around. We would also expect the benchmark of value to be based on the prices charged to similar consumers elsewhere. For example, in the mortgage market, thousands of mortgage prisoners are stuck on high Standard Variable Rates. In these cases the benchmark of value should be the fixed rates which are available to 95% of consumers in the market, rather than comparing the high Standard Variable Rates which few consumers in the active market pay for any significant length of time.

Q21: Do you have views on the PROA that are specific to the proposals for a Consumer Duty?

Q22: To what extent would a future decision to provide, or not provide, a PROA for breaches of the Consumer Duty have an influence on your answers to the other questions in this consultation?

We believe that it is vital that the FCA implements a Private Right of Action for breaches of the Consumer Duty. As we note above, the introduction of a New Consumer Duty will only be effective at reducing harm if it strengthens the incentives of firms and their senior managers to treat all customers fairly and, where harm is caused, to provide prompt and efficient redress.

Even with the addition of a private right of action we view it as unlikely that consumers individually or collectively will take court action to enforce their rights. The key advantage of making the Consumer Duty, the Overarching Cross-Cutting Rules, the Four Outcomes and the Principles actionable is that it would enable the FCA to utilise its powers under Section 404 of FSMA to require firms to pay redress to consumers where there has been the breach of a Principle.

Currently, gaps in a PROA for the principles can lead to the FCA negotiating arrangements behind closed doors or relying on consumer contact exercises to provide redress which lead to low response rates from consumers. These factors can lead to the perception that the FCA negotiates deals with the banks and then imposes them on victims. It also reduces the impact of the FCA's action as a low response rate to a redress or consumer contact exercise can mean that a bank still benefits financially from the misconduct. By allowing the FCA to impose a S404 redress scheme the new Consumer Duty could also reduce the administrative costs of redress programmes for both firms and consumers.

If a PROA is not introduced then it would weaken the impact of the overall package of proposals and we would not support them. In the longer-term as the Handbook text under the Four Outcomes expands it would introduce more gaps in the overall regime and would make it harder for the FCA to enforce and provide redress for consumers.

Helping shape financial policy

New City Agenda Ltd, 20-22 Wenlock Road, London N1 7GU

T: +44 (0)20 3397 7875 www.newcityagenda.co.uk Email: Dominic.Lindley@newcityagenda.co.uk