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A duty of care for financial services providers

A legislative proposal for a duty of care

The Financial Services Consumer Panel proposes that the Financial Services & Markets Act (FSMA) should be amended to require the Financial Conduct Authority (FCA) to make rules specifying what constitutes a 'reasonable' duty of care that financial services providers should owe towards their customers.

We are not proposing a fiduciary duty, but a duty of care that would oblige providers of financial services to avoid conflicts of interest and act in the best interests of their customers. A similar duty already exists for other sectors, for example, for legal and medical professionals through the Solicitors Regulation Authority's Principles¹ or the General Medical Council's Good Medical Practice Guide².

Whilst a duty of care of the type we propose would ultimately give consumers a legal right to take financial services providers to court, this is not the Panel's reason for suggesting it. The primary purpose of the duty of care would be to operate as a preventative measure, in particular by removing conflicts of interest. We would expect disputes to continue to be settled by the Financial Ombudsman Service (FOS) - recourse to the courts, bearing in mind its prohibitive cost, would only be a last resort.

Why we need a duty of care

The FSMA principle that firms should "treat customers fairly" (TCF) does not remove conflicts of interest and so does practically nothing to deter firms from mis-selling products and services. Once these practices are identified after the event consumers have to fight a long and stressful battle through the FOS to get compensation. Those outside the FOS's jurisdiction (eg small businesses) are often reliant on mass redress schemes that are imposed on them without proper consultation. This is costly and burdensome for them, and, for many, does not feel fair. Putting things right 'after the event' further diminishes trust in the financial services sector.

TCF only enshrines a weak duty to the consumer, further weakened by the legal principle in FSMA that consumers should 'take responsibility for their decisions'. The 'consumer responsibility' principle fails to take into account the imbalance in power between firms and their customers and information asymmetries. The Panel believes consumers can only reasonably be expected to take responsibility for their decisions where firms have exercised a duty of care.

A duty of care would rebalance the information and bargaining position asymmetries between firms and consumers and would operate to prevent poor conduct. Properly applied a duty of care might even eventually provide scope for a reduction in the amount of detailed rules.

How would it work?

The Panel's proposed amendment of FSMA would require the FCA to make rules on a duty of care, but the exact scope would be for the FCA to decide, subject to its normal consultation procedures. The Panel envisages that the rules would be flexible, and depend on the complexity and the risk of the product being sold. The more complex or risky the product, the more stringent the duty would be on the provider to ensure the product was suitable and that the customer understood what they were buying, and the risks involved.

The proposed duty would not affect the broad definition of 'consumer' in FSMA, so would apply to both wholesale and retail business. However, the primary intention would be to protect retail and smaller business customers. Accordingly, the Panel envisages that the FCA's rules would be most stringent for, for example, investment products offered to retail consumers, or complex hedging products aimed at small businesses.

What difference would it make?

A duty of care would engender long-term cultural change in financial services providers. It would bring much-needed clarity to the rules governing the relationship between firms and their customers. Properly supervised and enforced, an obligation for banks and other financial institutions to act in their customers' best interest would help prevent mis-selling and other poor behaviour towards customers from occurring in the first place.

Firms would no longer be able to adopt a "let's see if we can get away with it" approach, but would have to avoid conflicts of interest and take their customers' best interests into account at every stage of their engagement.

In short, a duty of care would effectively deliver what TCF is intended, but so clearly fails, to do.

¹ <http://www.sra.org.uk/solicitors/handbook/code/part2/content.page>.

² http://www.gmc-uk.org/guidance/good_medical_practice/duties_of_a_doctor.asp

Annex

There are numerous cases where TCF is failing customers, but where firms have not been breaking FCA rules, for example:

- In the savings market, banks can reduce interest rates on existing customers' accounts by declaring an account "obsolete". TCF only requires banks to tell customers about changes to the interest rates on their account range. Equally, new rules on disclosure of interest rates are not being applied to "obsolete" accounts (which are of course not obsolete from the customer's perspective). Under a duty of care, banks should ensure that customers of "obsolete" accounts were migrated to accounts offering at least as good value, without the requirement to open a new account.
- Banks continue to promote and reward staff on the basis of sales made to customers. PPI is the most egregious example of this; TCF makes no difference.
- If a customer tries to withdraw funds beyond their overdraft limit, banks can allow the withdrawal without telling the customer at the point of making the decision what charges will result. Under TCF, as long as the customer has been told the charging structure, this is considered fair. Under a duty of care, the bank would be required to inform the customer of the likely charges before the withdrawal.
- The recent FCA thematic review into early arrears management in unsecured lending shows that firms are still missing early opportunities to identify customers in financial difficulty and offer appropriate forbearance. Moreover, the findings showed that a firm's culture influences the approach taken to giving due consideration and forbearance to customers in arrears difficulties. Under a duty of care, firms' intentions towards assisting customers in arrears would always focus on achieving fair customer outcomes.

These may seem like trivial examples, but they are not trivial to the millions of consumers struggling to make ends meet, who the government has pledged to help.