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2 November 2018

By email: dutyofcare@fca.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to DP18/5 – Discussion Paper on a duty of care and potential alternative approaches

Introduction

The Financial Services Consumer Panel (Panel) has long called for the introduction of a duty of care to be owed by financial services providers to their customers. We welcome the FCA's decision to have this debate now. It is helpful that the Discussion Paper refers to a "New Duty", which encompasses a range of options, and enables the debate to move away from the legal semantics with which some seek to surround it.

The principles for businesses – and principles 6 ("Customers' interests" – commonly known as "Treating Customers Fairly" or "TCF") and 8 ("Conflicts of interest") in particular – do not give financial services customers an appropriate level of protection. This applies to the way in which firms interpret the principles and the way in which the FCA enforces them.

A new duty is required to improve the position of all consumers of financial services, including those who need more support.

The Panel's intention is to achieve the following benefits:

- **better treatment of financial services customers** - there is ample evidence of firms clearly not complying with the principles for businesses, but not technically breaching any FCA rules (see Annex A). While FCA enforcement notices spell out which principles have been breached, it is rare for the FCA to enforce against the principles unless rules have also been broken. A new duty should give the FCA more confidence to enforce against a breach of the principles, ensuring that firms took them more seriously than is currently the case;
- **better balance between firm and customer responsibilities** – financial products are complex – often unnecessarily so - and the long and impenetrable terms and conditions are non-negotiable. This gives rise to massive asymmetries of knowledge, understanding and bargaining power between firms and their customers. A new duty would help address these asymmetries and establish a fair balance of firm and customer responsibilities;
- **focus on prevention** – a new duty would encourage firms to identify potential customer harm and avoid it, in line with the stated aim of the FCA's Mission (and its associated approach documents)¹ to focus on prevention rather than 'cure';
- **change in firm culture** – there is no incentive for firms to improve their organisational culture. The interests of firms, their shareholders and customers are not well aligned.

¹ <https://www.fca.org.uk/publications/corporate-documents/our-approach>

Competition does not work effectively in the consumer interest. A new duty would encourage firms to pay more heed to good customer outcomes when setting strategy and building business models to deliver it; and

- **application of fair treatment to all customers** – the Financial Ombudsman Service (FOS) takes account of the principles for businesses as part of the “fair and reasonable” test which it applies when resolving disputes. A new duty would mean that more effective protection would apply to all consumers and not just those with the time, energy and inclination to take a dispute to the FOS. This should benefit the more vulnerable in particular.

On 29 October 2018 the FCA published complaints figures for the first half of the year, which have risen to a record high of more than 4,100,000². Excluding PPI, complaints increased by 9% from the previous six months. This level of complaints and the continuing high level of uphold rates further support the need for a new duty.

Alignment with FCA objectives and current priorities

A new duty would help create a consistent approach to financial services regulation that would minimise harm and be based on individual customers’ best interests. It would be entirely consistent with the FCA’s three operational objectives:

- **securing an appropriate degree of protection for consumers** – this is not happening now: failing to stop the behaviours that firms continue to demonstrate cannot be described as an ‘appropriate’ level of protection³;
- **protecting and enhancing the integrity of the United Kingdom’s financial system** – by helping to restore customer confidence in financial services firms; and
- **promoting effective competition in the interests of consumers** – competition is neither effective, nor does it operate in the interests of consumers. There may be churn in some markets, but information asymmetries and conflicts of interest work against consumers finding a genuinely better deal so firms have no incentive to improve their products and services. Open Banking and the implementation of the Second Payment Services Directive may help change this for consumers willing and able to share their data. Whether they will do so in sufficient numbers to drive changes in the market remains to be seen. A new duty would ensure those who want to switch providers have the right information to do so, and that those who don’t – or can’t – are adequately protected from exploitation.

A new duty would also be compatible with FCA priorities.

The FCA Mission, published in 2017, and the subsequent Approach documents all highlight the desirability of moving to a preventative system of regulation, where potential harms are identified early so that consumers can be protected before they incur loss. A new duty is a vital element of a “prevention not cure” regulatory approach as it has an implicit requirement on firms to pay attention to the circumstances of individual customers at every stage.

The FCA is concerned that that culture within firms is not what it should be⁴. The Panel agrees. Our 2015 research showed a clear link between firm culture and customer outcomes and the role which a new duty could play in improving those outcomes⁵.

The FCA has voiced concern about the issue of long-standing customers being charged more for some financial products than new customers, and this has informed its work on cash

² <https://www.fca.org.uk/news/press-releases/fca-data-shows-increase-complaints-more-4-million-during-first-half-2018>

³ https://www.fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017_2.pdf

⁴ <https://www.fca.org.uk/publication/discussion/dp18-02.pdf>

⁵ https://www.fs-cp.org.uk/sites/default/files/bank_culture_position_paper_final.pdf

savings and mortgages. Following Citizens' Advice's super-complaint to the Competition and Market Authority (CMA) on excessive prices for disengaged consumers⁶, the FCA announced a market study looking into how general insurance firms charge their customers⁷. Many of the examples in Annex A involve poor treatment of existing customers.

The FCA has also recently taken steps to extend the operation of the Senior Managers and Certification Regime (SMCR) to all financial services sectors. It is not clear whether the SMCR makes an individual fully accountable for outcomes under each principle. A new duty would complement the SMCR regime and make it more effective as a regulatory tool.

What would a new duty look like?

In the past the Panel has called for the implementation of a statutory duty of care by way of an amendment to the Financial Services and Markets Act 2000. While that remains our long term aim, we recognise legislation would take time, and we are keen to see whether other options might deliver the same benefits faster.

The Panel does not see a new duty as "filling a regulatory gap" as the Discussion Paper suggests it might. Clearly the FCA has sufficient tools at its disposal, including non-financial services legislation. The point is that the tools are not doing the job. Rather than filling a gap, the Panel sees a new duty as upping the level of protection available to consumers. Principles for businesses 6 ("TCF") and 8 ("Conflicts of interest") are demonstrably not providing consumers with an appropriate degree of protection.

The Panel proposes replacing them with strengthened principles, as follows:

"6. **Customers' interests** – A firm must act in the best interests of all its customers and treat them fairly."

"8. **Conflicts of interest** – A firm must manage conflicts of interest, both between itself and its customers and between different groups of its customers, fairly and so as to avoid customer harm."

The FCA Handbook already contains high-level rules which require firms to act in accordance with the best interests of their customers. These rules derive from European Union directives and apply to certain investment business, mortgage activities and insurance distribution. There is no reason why 'best interests' should not apply across financial services. Moreover, enshrining this concept in the FCA's principles would guard against post-Brexit attempts to water it down in those sectors to which it already applies.

It is essential that these amended principles should be actionable by individual customers. While this right would be unlikely to be exercised frequently, if at all, it would force firms to focus on improving consumer outcomes. If the industry is concerned about the prospect and potential scale of litigation then we would make the obvious point that the best way of avoiding this would be not to breach the principles. The Panel also suggests that the FCA should introduce a 'super-complaint' process to enable designated consumer groups to challenge breaches of the principles, in line with the 2002 Enterprise Act.

The Panel also proposes that the FCA should amend the principle of good regulation 4 which concerns consumer responsibility⁸ along the following lines (suggested new text in **bold**):

⁶ <https://www.fca.org.uk/news/statements/super-complaint-citizens-advice-cma-excessive-prices-disengaged-consumers>

⁷ <https://www.fca.org.uk/news/press-releases/fca-launches-general-insurance-market-study>

⁸ <https://www.fca.org.uk/about/principles-good-regulation>

“4. Consumer responsibility – Consumers should take responsibility for their decisions where they are capable of doing so, and where firms have complied with the principles for businesses.”

This would help to reinforce the need for firms to take the revised principles for businesses 6 and 8 seriously. The Panel has always maintained that consumer responsibility can only be reasonably expected if firms comply with the principles for business, and this makes that linkage more explicit.

To help firms interpret and apply these amended principles, the Panel would envisage the FCA providing formal guidance, updating the TCF consumer outcomes⁹, and explaining how the SMCR would operate to ensure the effectiveness of the new duty. The Panel’s suggestions for the reformulated consumer outcomes are set out at Annex C.

What difference would a new duty make?

A new duty would redress the balance of responsibilities between firms and their customers. It would promote the benefits set out above and enable firms to demonstrate that they are worthy of their customers’ trust.

Perhaps most importantly of all, a new duty would avoid the numerous occasions when the behaviour of a firm towards its customers breaches the FCA’s principles for businesses but does not break its detailed rules. These “legal but not right” actions usually mean that customers lose out while firms are not held to account. Annex A contains examples of the poor customer outcomes which the new duty needs to address. As well as stopping the most egregious behaviour, a new duty could reduce detailed FCA intervention and change the way the market operates, for example:

- the FCA would not need to introduce a Basic Savings Rate, as firms should ensure their customers get the best available rate;
- banks should adopt a more proactive, preventative approach to tackling Authorised Push Payment (APP) fraud, investing in anti-fraud measures rather than telling customers how to ‘protect themselves’; and
- rather than adopting a compartmentalised approach to customers with certain types of vulnerability, firms would need to develop a more holistic approach to take account of individual customers’ needs and circumstances, raising the standard of care for all customers, including those who require extra support by virtue of their characteristics or circumstances.

What do consumers think?

Much of the debate on a duty of care has centred on legalistic arguments about whether there is a ‘gap’ in protection. What matters is whether consumers get the treatment they want and expect from their financial services providers. The Panel commissioned Populus to ask individual and small business customers about their experiences¹⁰.

The research showed that the customer is not at the heart of business decisions:

⁹ <https://www.fca.org.uk/firms/fair-treatment-customers>

¹⁰ The research is published alongside this response and can be found at https://www.fs-cp.org.uk/sites/default/files/populus_doc_report_for_publication_final.pptx_.pdf. Populus interviewed both consumers and small businesses. The consumer sample comprised of 2079 UK adults aged 18+ interviewed online between 21st – 23rd of September 2018. Surveys were conducted across the country and the results have been weighted to the profile of all adults. The business sample contained 503 individuals of director level and above working in small businesses (0-49 employees) who were interviewed online between the 24th – 30th of September 2018. Populus is a founder member of the British Polling Council and abides by its rules.

- Fewer than 30% of respondents felt that their bank always acts in their interests when dealing with their money, with nearly 60% believing their bank always acts in its own interest.
- 85% said their bank should automatically give them the best savings rate they offer. Fewer than 20% believed their bank does this.
- Nearly 90% believed their insurer should reward them for staying with them. But only 20% believed their loyalty was rewarded the last time they renewed a policy.
- 80% thought their lender should not lend them more than they could reasonably afford to repay. But nearly 20% said at least one lender had done so.
- Similarly, 80% said their credit card provider should not increase their credit limit without asking them first. But nearly 40% said at least one of their current credit card providers had done so.
- The majority of small business respondents said their bank should give them guidance about the best financing options for their business, and access to staff who understand their needs and are empowered to make decisions. Fewer than half said they receive these services.

In light of this experience, it is not surprising that over 90% of those surveyed were in favour of a duty of care.

Arguments against a new duty

The industry has set out a number of arguments against a new duty. We respond to these below:

- **A new duty would add nothing – it would simply complicate the position further**
A new duty is needed to enable the FCA to provide an appropriate level of protection, in line with its consumer protection operational objective – it should clarify not complicate.
- **A new duty would force firms to put consumer interests ahead of the interests of shareholders**
A new duty would protect shareholder interests by helping to avoid the need for compensation payouts for firms' poor practice¹¹. Other sectors, such as the legal profession, appear perfectly capable of operating with a duty of care whilst maximising profits.
- **There is no shortage of existing rules, laws and duties so a new duty is not needed**
The existing legal framework is not delivering good consumer outcomes. The existing principles are no longer fit for purpose – over time a new duty could even pave the way for the reduction and simplification of other rules.
- **TCF provides consumers with the protection they need**
There is ample evidence that it doesn't.
- **A new duty would stifle innovation and so reduce the number of products available to consumers**
Innovation should meet customer needs, not just generate more products. Greater clarity and customer focus should help achieve this.
- **The SMCR already ensures consumers are protected**

¹¹ For example, since January 2011 firms have paid out £32.6bn in compensation to consumers for the way they sold payment protection insurance (PPI). Source: <https://www.fca.org.uk/data/monthly-ppi-refunds-and-compensation>

The SMCR is primarily a supervision tool – it will be a valuable mechanism to ensure that firms are complying with a new duty.

- **A new duty would lead to a huge increase in litigation**

Consumers are unlikely to embark on the costly and uncertain route of litigation unless they are pretty sure they have been badly treated and have access to substantial funds. The Panel does not accept that creating a right of private action is disproportionate, but rather considers that it will create a helpful incentive. The simplest way to avoid litigation would be not to breach the principles.

Annex B sets out the Panel's responses to the questions in the Discussion Paper.

Yours faithfully,

Sue Lewis
Chair, Financial Services Consumer Panel

Annex A – Examples of breaches of the principles for businesses that have not broken FCA detailed rules

Savings

- Banks can reduce interest rates on customers' accounts by declaring an account "obsolete". FCA rules only requires banks to tell customers about changes to the interest rates on their account range. Equally, rules on disclosure of interest rates do not apply to "obsolete" accounts (which are not obsolete from the customer's perspective).

Overdrafts

- If a customer tries to withdraw funds beyond their overdraft limit, a bank can allow this without telling the customer at the point of making the decision what charges will result. As long as the customer has been told the charging structure, this is compliant with the rules.
- Unarranged overdraft fees exploit consumers' financial difficulty. Small errors can lead to charges that far exceed marginal cost, and may even exceed the payday loan cap. The majority of unarranged overdraft fees are paid by only 1.5% of customers, who pay on average around £450 a year.

Investments

- Many firms offer online investment services that are 'execution only', i.e. the consumer makes the choice of investment rather than receiving a personal recommendation. Many of these services fail to make costs and charges, or liability, clear.
- The FOS continues to uphold complaints against advisers for charging trail commission when it is unclear what service they are providing or indeed when no service is received at all.¹²
- Some firms charge active management fees for passive strategies.

Investments

- Investment management firms launch better value fund share classes with lower charges but leave loyal customers in older more expensive share classes and do not inform them that cheaper share classes are available.

General Insurance

- In meeting the 'treating customers fairly' principle, insurers have a responsibility to tell their customers what they're paying in a way that's not misleading – and that allows them to make an informed choice. The FOS says that in a small but significant number of cases, this doesn't happen – and people are paying the price for loyalty in a way that's not fair.¹³
- Insurers charge individual prices that are disproportionate to actual risk.¹⁴

Mortgages

- Mortgage firms keep captive customers on higher SVRs and fail to offer them the ability to move to cheaper fixed rates.

¹² <http://www.ombudsman-decisions.org.uk/viewPDF.aspx?FileID=176500>

¹³ <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/144/pdf/issue144.pdf>

¹⁴ <https://www.fca.org.uk/publication/market-studies/ms18-1-1.pdf>

Consumer Credit

- Credit card companies frequently offer inappropriate products with unaffordable credit limits to consumers. A Citizens' Advice survey found that 6 million people had had their credit limit increased in the previous year without their consent. A third of those showing signs of struggling financially were given an increase, potentially making their financial problems worse¹⁵. The FOS also upholds complaints against credit card firms who have withdrawn promotional interest rates on credit card products unfairly.¹⁶

¹⁵ <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/credit-card-companies-pushing-credit-on-millions-of-people-who-cant-pay/>

¹⁶ <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/113/113-credit-cards.html#cs1>

Annex B - FCA Questions for discussion (DP18/5)

Question 1

Do you believe there is a gap in the FCA's existing regulatory framework that could be addressed by introducing a New Duty, whether through a duty of care or other change(s)?

The FCA is a principles-based regulator. It sets out a series of principles which, because of the complex nature of financial services products, have to be supplemented by numerous rules, many of which derive from EU legislation. There is nothing wrong with this approach, but the principles for businesses and in particular principles for businesses 6 ("Customers' interests", commonly known as "Treating Customers Fairly" or "TCF") and 8 ("Conflicts of interest") are demonstrably not providing consumers with an appropriate degree of protection. This is not about a 'gap' in the regulatory framework - the FCA has the tools to protect consumers, including non-financial services legislation. The issue is that it does not do so adequately. A new duty should give the FCA the confidence to act decisively and prevent harm occurring, in line with its statutory consumer protection objective and 2017 Mission statement.

Question 2

What might a New Duty for firms in financial services do to enhance positive behaviour and conduct from firms in the financial services market, and incentivise good consumer outcomes?

Culture drives the way financial services firms behave. This has not been good enough and consumers have far too often paid the price.

The Panel's proposed new duty - that *firms should act in the best interests of all their customers and manage conflicts of interest fairly and so as to avoid customer harm* - would force them to place their customers at the heart of their businesses, as many already claim to do, despite overwhelming evidence to the contrary. Making the principles actionable would give firms a sharper incentive to do the right thing. This would lead to a change in firm culture, driving positive behaviour and conduct where customers are genuinely treated fairly, and achieve good outcomes.

A greater emphasis on consumer outcomes would move firms away from a rules-based compliance culture to one where harms are identified at a much earlier stage and so can be avoided.

A new duty should encourage increased professionalism and ethical behaviours.

Question 3

How would a New Duty increase our effectiveness in preventing and tackling harm and achieving good outcomes for consumers?

A new duty would make firms think much harder about consumer outcomes when considering their strategies and business models. This should reduce the need for detailed FCA intervention to ensure good customer outcomes, enabling it to focus on other areas. By supervising firms' compliance with the new duty, the FCA would be in a better position to identify and prevent consumer harm in line with its Mission.

Do you believe that the way we regulate results in a gap that a New Duty would address?

Firms like certainty, so the inevitable focus of the FCA's regulation is the rulebook and this has led to much less attention being paid to the principles by both firms and the FCA. This in turn has meant that no-one seems to understand what "treating customers fairly" means. Firms seem to think that compliance with the rules will achieve compliance with the principles and the FCA does little to dispel this notion in terms of taking firm and consistent action for breach of the principles.

A new duty would be clearly expressed, including appropriate FCA guidance, so that everyone - firms, customers and the regulator - would know what it means for them.

Question 4

Should the FCA reconsider whether breaches of the principles should give rise to a private right for damages in court?

Or should breaching a New Duty give this right?

In calling for a statutory duty of care the Panel has implicitly been calling for a private right of action for customers of firms which breach that duty. This would be an important component of a new duty. This is not because any such right would be frequently exercised – the costs would be prohibitive for all but a few – but rather because the fact that individual customers could take action would make it far more likely that firms would change their culture in the fundamental way required so that a new duty would have the desired effect of improving consumer outcomes.

Some firms have used the fact that a new duty might include a private right of action as an argument against any form of new duty. They believe that this would lead to masses of litigation. Leaving aside that cost alone makes this unlikely, surely it would only happen if the firm was behaving in a way that called its compliance with the new duty into question?

We note that, even in those markets where a 'best interests' principle already applies, poor behaviour continues. Providers in these markets also need a sharper incentive to treat customers fairly and ensure good outcomes.

The Panel does not accept that creating a right of private action is disproportionate but rather considers that it will create a helpful incentive. The Panel also suggests that the FCA should introduce a 'super-complaint' process to enable designated consumer groups to challenge breaches of the principles, in line with the 2002 Enterprise Act.

Question 5

Do you believe that a New Duty would be more effective in preventing harm and would therefore mean that redress would need to be relied on less?

Yes. It follows that a reduction in causes of harm would lead to less actual harm and so less need for redress.

Annex C – Consumer Panel suggestions for reformulated consumer outcomes

Fair treatment of customers

All firms must be able to show consistently that customers' best interests are at the heart of their business model, and that they manage conflicts of interests in a way that avoids harm.

Consumer outcomes

There are six consumer outcomes that firms should achieve to ensure fair treatment of customers. These remain core to what we expect of firms.

- **Outcome 1:** Consumers can be confident the firm has their best interests at heart, that they will be treated as an individual, and that they will always get the best deal the firm offers.
- **Outcome 2:** Products and services meet identified consumer needs and circumstances, and are not unnecessarily complex.
- **Outcome 3:** Consumers understand what they are buying, what it costs (including any contingent charges), and any associated risks. Firms update consumers immediately on any post sale changes to terms and conditions.
- **Outcome 4:** Where consumers receive advice, the advice is suitable and takes account of their circumstances.
- **Outcome 5:** Consumers are not discriminated against if they do not want to switch to another provider, or if they do not want to share their data.
- **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.