

## **CONSUMER RESPONSIBILITY**

### **Consumer Panel Position Paper**

#### **1 Panel position**

- 1.1 The latest draft of the Financial Services Bill incorporates a high level principle that consumers are responsible for their decisions. The existing Financial Services and Markets Act requires the Financial Services Authority to 'have regard' to the principle that consumers should take responsibility for their decisions, in the discharging of its consumer protection objective (HM Treasury, 2011). The new approach of the Financial Conduct Authority will be 'proactive and intrusive' but it will not 'absolve consumer of responsibilities for their own decisions' (Sants, 2011).
- 1.2 The Panel has concerns about the principle of consumer responsibility: Its meaning is broadly interpreted by stakeholders but in law there are no obligations placed on consumers other than to act honestly. Also, it is not clear to the Panel what a greater emphasis on 'consumer responsibility' might achieve. There has been no industry argument against regulatory intervention in any particular case the Panel is aware of on the basis that consumers should have taken greater responsibility. Moreover, the FSA's own feedback paper in response to the discussion paper on consumer responsibility in 2009 made it clear that while consumers had a 'general' responsibility to act in an honest way, no *specific* responsibilities could be legislated for.
- 1.3 In a market where product complexity is high, the nature of risk is not transparent, and natural human behavioural biases have been exploited in a one-sided way, the Panel questions the need to incorporate any greater responsibility on the part of consumers within the framework of financial regulation. Indeed, given the asymmetrical power in financial services, the Panel strongly advocates the introduction of the principle that firms have a fiduciary duty towards their customers into the current Financial Services Bill.

#### **2 *The definition of 'consumer responsibility'***

- 2.1 'Consumers' are defined broadly by the Financial Services and Markets Act. This is helpful in ensuring that both potential and existing service users are considered in regulation. However, the breadth of the definition can cause some confusion. Currently 'consumers' also includes 'consumers' of wholesale markets: ie, those people who act on behalf of retail consumers, often pensioners. Similarly, although widely used, 'consumer responsibility' has different meanings

according to the context in which it is used. This lack of clarity over actual definitions can confuse the debate about the nature of 'consumer responsibility', particularly where 'consumer responsibility' is used as a stand alone concept. In this paper we refer to consumer responsibility in relation to retail consumers.

### **3 *Different perspectives***

- 3.1 Such confusion over terminology and scope has allowed 'consumer responsibility' to gain traction among a variety of groups. Often their definitions vary considerably. For instance, successive UK governments have increasingly tried to shift risk and responsibility away from the state on to individuals in order to deliver various policy objectives; while in financial services, industry professionals tend to interpret 'increasing consumer responsibility' as a way of negotiating the limits of consumer protection and, arguably, reducing their own liabilities. Consumers themselves see 'consumer responsibility' as their existing legal obligations to disclose information, but are confused as to further responsibilities.
- 3.2 In its consultation document on regulation reform, HM Treasury explains that 'consumers are ultimately responsible for looking after their own interests and choices they make' (HM Treasury, 2011). The FSA's own discussion paper on consumer responsibility in 2009 notes the common law concept of 'caveat emptor' – buyer beware. Consumers should take actions to protect their own interests. Yet, as the Panel's own research pointed out at that time, this particular notion does not relate to the financial services sector.

### **4 *The nature of the current debate***

- 4.1 The debate about consumer responsibility continues however, because it relates to the boundaries of regulation, which by their nature are subject to regular negotiation.
- 4.2 Regulatory boundaries form the crux of the debate about consumer responsibility: What can consumers expect from financial firms? What is the nature of redress when financial transactions go wrong? And for the consequences of which decisions must consumers deal with personally?
- 4.3 From an industry point of view answers to the questions are equally important: how far can they go in pursuing commercial interests? What are they *obliged* to do for their customers? And how can they avoid the expense of redress, which often takes years to surface, while maximising profit making opportunities? The industry is keen to minimise its liabilities and protect itself from claims arising many years hence.

4.4 Underpinning this debate is the distortion of what should be a mutually beneficial relationship. Financial services' companies have a duty to follow commercial interests (on behalf of shareholders) which should be driven by the needs of customers who pay for products and services (and to whom no such comparable duty is owed). Too often this relationship is characterised by conflict between commercial and customer interests, where duty to shareholders trumps customers' needs.

## **5 *A unique relationship***

5.1 The concept of 'consumer responsibility' is made more challenging by the nature of the specific relationship between financial service providers and consumers, where it is widely acknowledged (HM Treasury, 2011<sup>1</sup>) that consumers are disadvantaged by:

- the particular nature of financial products and services;
- the information, capability and resource asymmetries which are loaded in favour of firms;
- unknown (and concealed) levels of risk sharing;
- natural behavioural biases all humans are subject to; and,
- regulation itself.

## **6 *Product complexity***

6.1 Financial products are often highly complex and bought infrequently so it is difficult for consumers to learn from past experience. Indeed, many products and their inherent risks remain incomprehensible even to those producing and selling them. Even 'simple' products require assessment of possible variables and complex trade-offs. For instance, a traditional annuity may be fairly straightforward to understand conceptually, but the decision making required to assess personal suitability, additional variables (like single or joint) and the impact of decisions on the final product bought is complex.

6.2 All products involve an element of risk which few consumers are well-equipped to judge. They are often credence goods – meaning that consumers won't know if they have performed as expected until a number of years have passed. Services are also opaque as reward and incentive schemes within firms can distort the sales and advice process or leave groups without access to advice at all.

6.3 In other industries, EU laws prevent the marketing of unsafe products and provide that manufacturers are liable for injuries caused by

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<sup>1</sup> Para 4.26 A new approach to financial regulation: building a stronger system CM 8012 February 2011 [http://www.hm-treasury.gov.uk/d/consult\\_newfinancial\\_regulation170211.pdf](http://www.hm-treasury.gov.uk/d/consult_newfinancial_regulation170211.pdf)

defective goods. Consumers have rights in relation to faulty products, and many products are covered by EU or UK technical standards.

## **7     *The nature of risk***

- 7.1    The level of risk a consumer takes when buying a financial product is also unclear. The meaning of words such as “guaranteed” or “tracker” can and often do differ from the meaning of the same word in common use. From deposits which are deemed ‘secure’ to exchange traded funds and complex investment products, consumers are bearing a level of risk which is often unknown to them and seldom explained by manufacturers in ways which are meaningful. Consumers are thus often unaware of the level of risk they bear in a product or transaction and are again put at a disadvantage.
- 7.2    This inability to assess the credibility and viability of a firm creates additional moral hazard. Financial contracts are often unintelligible, pre-printed and non-negotiable, exacerbating the consumer disadvantage. And yet, in the case of non-compulsory insurance there is still an expectation that they will bear at least 10% of the risk should a company go bankrupt, as the Financial Services Compensation Scheme will only refund 90% of losses.

## **8     *Behavioural biases***

- 8.1    Humans are subject to a number of behavioural biases. These biases affect behaviour and decisions in predictable ways. For instance, the ‘status quo’ bias means that many will not bother to shop around. Businesses are able to exploit these biases to their advantage. For instance, with regard the ‘status quo bias’, firms often attract new customers with good initial rates before quickly moving them onto poor rates, assuming (often correctly) that customers will not move on. ‘Competition’ for new savers is strong, but the outcome is, arguably, not good for customers overall. On the flipside, staff in companies struggle with the same biases, often churning out their own version of a product which is selling well for a competitor without stopping to think if the features fit with their own customer base or ethos. ‘Herd mentality’ (another bias) prevails. Strong price competition can simply lead to a ‘race to the bottom’ where product quality is reduced to save costs: for instance, in the hollowing out of general insurance products.

## **9     *Enforcement challenges***

- 9.1    Finally, consumers are disadvantaged by the regulation that is due to protect them. Where the FSA may investigate companies for inappropriate practices, currently consumers do not have any notice of this fact until enforcement action has been brought, which may be some 18 months-2 years down the line. It is not clear how a consumer

can protect their own interests in such cases, where they are not aware of all the facts.

## **10 Conclusions**

- 10.1 The debate about ‘consumer responsibility’ looks set to continue, but the Panel believes its focus is misplaced. In an industry beset with low levels of compliance and high levels of complaints, and no agreed standards for complex and long term products, there is little case for expecting consumers of financial services to adopt a higher degree of responsibility than is already legally acknowledged or is found in other retail sectors. A better focus for debate would be on how best to create a market driven by the pursuit of good consumer outcomes which benefit both shareholder and society.
- 10.2 While the Panel recognises the importance of services like the Money Advice Service and supports steps that can be taken to improve financial capability, firms will always have more information, capability and resource at their disposal than the consumers they interact with. Awareness of customer supporting bodies like the Financial Services Compensation Scheme and the Financial Ombudsman Service is low and only half of customers who remain dissatisfied with a firm’s response to their complaint go on to pursue it with the Ombudsman<sup>2</sup>. Given the complexity of the financial services sector, knowledge is, indeed, power and the power is not in the hands of the consumer. It is for these reasons that the Panel has concerns about attempting to impose a principle of consumer responsibility.

## **Financial Services Consumer Panel February 2012**

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<sup>2</sup> Financial Ombudsman Service Annual Review 2010/11 at [www.financial-ombudsman.org.uk](http://www.financial-ombudsman.org.uk)