

Future of Financial Services Week

Stronger regulation – the FCA's new Consumer Duty

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Speaking with you today



Nikki Worden

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Nikki leads Osborne Clarke's Financial Institutions Group, specialising in FinTech and the regulation of financial services offered to consumers and small businesses, including consumer credit regulation. She advises on the impact of FCA regulation across a range of clients, from disruptive new market entrants to large lenders and retail banks; and from asset finance providers to tech companies.

Nikki advises clients on whether their activities fall within the FCA regime and on authorisation applications and helps clients structure and launch new products and services aimed at consumers and small businesses. She also advises on the full range of conduct of business requirements from financial promotions and customer journeys to creditworthiness and affordability, and from forbearance and collections to persistent debt.

Nikki drafts terms and conditions and notices for a wide range of products including loans, business cash advance products, current and savings accounts, credit cards, regulated hire products and PCP products. She works closely with other FinTech specialists at Osborne Clarke to provide holistic support for fast-growing firms.



James Turner

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James is an Associate Director in the Financial Institutions Group, helping clients innovate and thrive in payments, e-money and consumer finance.

A consumer credit and consumer protection lawyer by training, since 2009 he has been immersed in payments regulation and innovation, alongside advising on all aspects of the regulation of consumer credit, retail banking and mortgages. He has particularly deep experience in regulatory change, having led on the implementation of both Payment Services Directives, BCOBS, CONC, the Mortgage Credit Directive, the Consumer Credit Directive, the Consumer Rights Act and the ring-fencing rules introduced by the Financial Services (Banking Reform) Act, among other regimes.

His work often involves the regulatory perimeter and product design, ensuring that regulated products and paperwork are compliant, user-friendly, fair and commercial. He also has significant experience of bringing his expertise in this sector to transactions, remediations and disputes (including the test cases on bank charges, and CCA section 75, both of which reached the House of Lords/Supreme Court).



Nick Price

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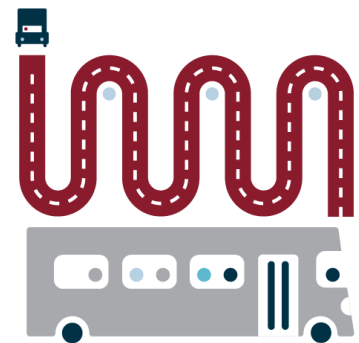
Nick helps regulated firms with the risk of investigation or enforcement action by regulators, and disputes in the payments, cryptoassets, and fintech sectors.

Nick has years of experience acting for financial institutions, regulated individuals, and other participants in the financial services sector. He has a focus on traditional and disrupter payments clients, and fintech clients, particularly those dealing in cryptoassets.

Alongside the regulatory focus, Nick regularly advised client on business-critical regulatory investigations and judicial reviews, high-value disputes in the financial sector and pharmaceutical sector.

Entrance Poll Question: How concerned are you about compliance with the Consumer Duty, when it comes into force?

- A. Very concerned, this is going to be a big project
- B. Quite concerned, I think we are mostly compliant already
- C. Unconcerned, we've got this
- D. No idea of the potential impacts on our business



Context for the new Consumer Duty

- FCA Discussion Paper (DP18/05) was published July 2018: 'A duty of care and potential alternative approaches'
 - FCA Feedback Statement (FS19/02) was published in April 2019 considering options for change.
 - Financial Services Act 2021 required FCA to consult on whether it should make rules providing for a duty of care for authorised persons.
- FCA consultation (CP21/13) was published May 2021, consultation closed on 31 July 2021.
 - Second consultation (CP21/36) was published December, closes on 15th February 2022.
 - Policy statement confirming new rules to be published by 31 July 2022.

Harms to be addressed

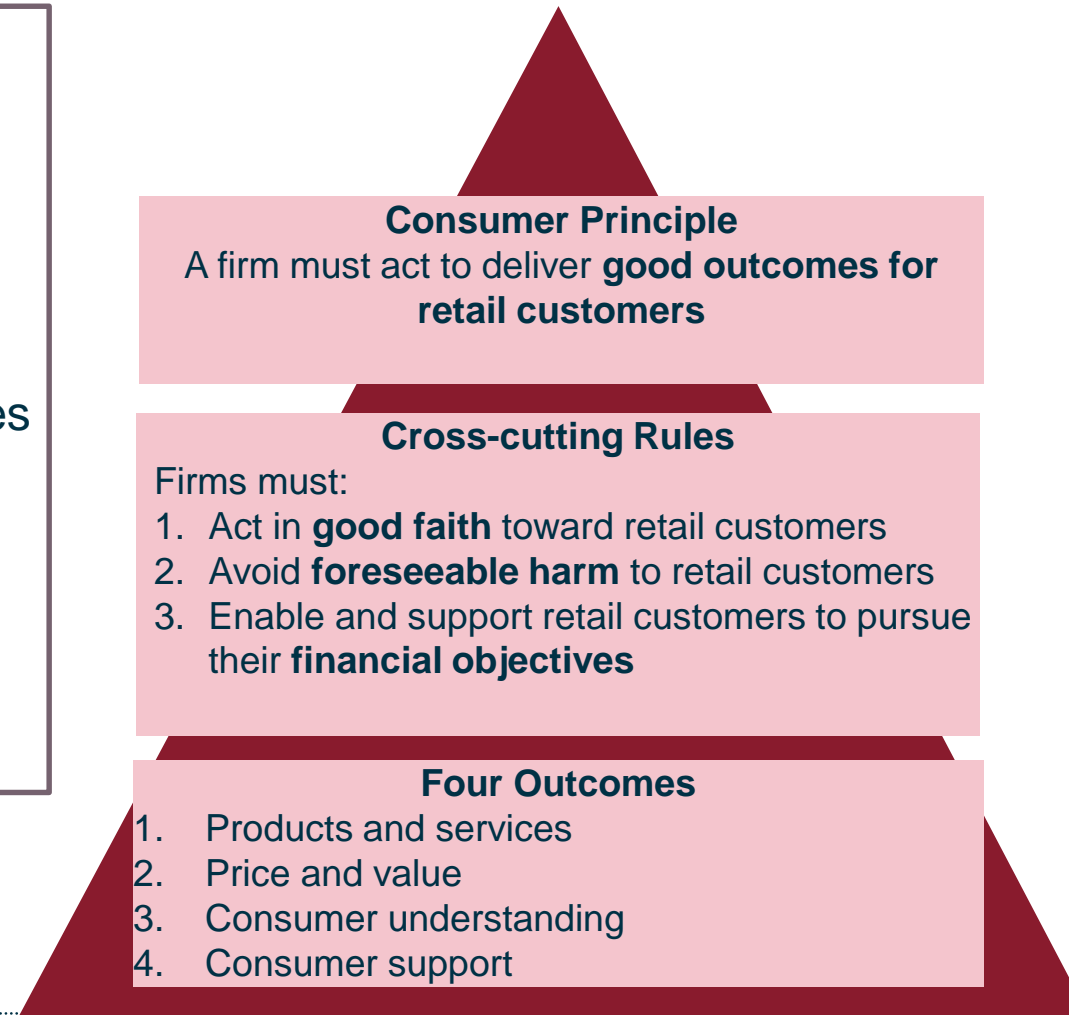
- Consumers don't always make good decisions and this can be exploited by firms.
- Firms exploit customer loyalty or inertia.
- Too many firms are not adequately considering the needs of their customers or prioritising good outcomes when designing products.
- Firms are selling products and services that do not represent 'fair value'.
- Firms are providing poor customer support that hinders customers from properly managing the finances thereby increasing costs.

Proposed Framework

See the second FCA consultation on the Consumer Duty at:
<https://www.fca.org.uk/publication/consultation/cp21-36.pdf>

The Consultation has:

- 51 pages of draft Handbook amendments including material additions to PRIN, COCON and the Glossary – designed to underpin Principle 12 and the cross-cutting rules
- 71 pages of non-Handbook guidance on the Consumer Duty
- So now is the time to shape the detail where you can.



New Senior Manager individual conduct rule:

You must act to deliver good outcomes for retail customers



Scope of the new Consumer Duty

"Retail customers" protected

- NB: **Consumer** Duty is a misnomer!
- CP21/13 defined "**retail clients**" as everyone except professional clients and eligible counterparties, i.e. catching most SMEs
- FCA recognised that having a uniform line cut across existing regimes
- Therefore have now amended the definition of "retail customer" to align to the substantive protections in each regime, e.g. contrast payment services and e-money with ICOBS

Distribution chain

- Retail customer includes "the end retail customer in the distribution chain whether or not they are a direct client".
- NB new defined term of "retail market business" and new PRIN 2A.1.5G + 3.2.
- Clearer than CP21/13, which had raised questions over, e.g. agency banking and merchant acquiring: now clear that the FCA's intention is not to capture true wholesale activities
- But the key: you can be caught even if it's not your customer

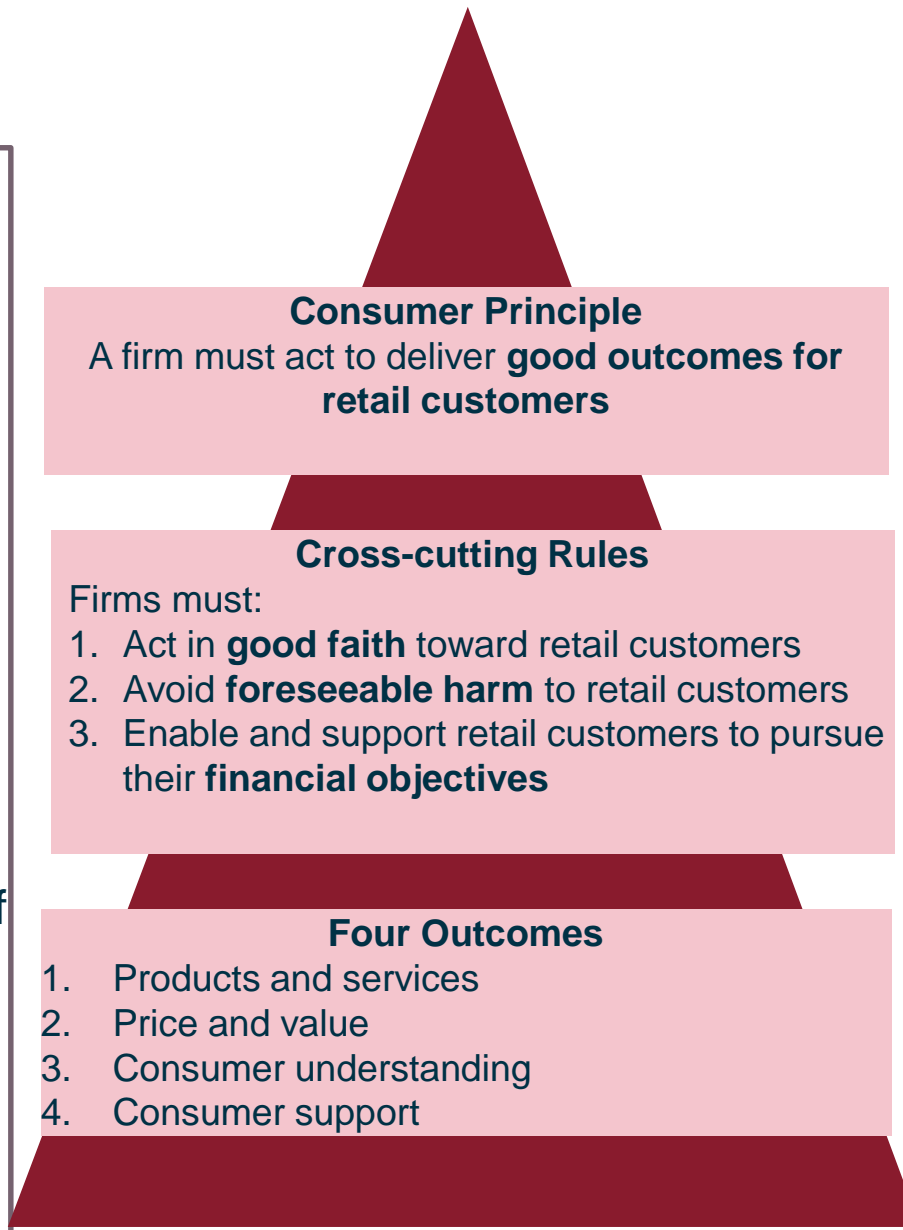
Impact on backbook (ch 4)

- Duty not retrospective, BUT...
- Will apply to any products operating or being sold at the point of implementation...
- So it will be "sort of" retrospective: existing portfolios, whether closed or open, will need to be compliant – although not all rules apply (e.g. identifying a target market for a closed book)



Practical impacts

- Outcomes focussed regulation means firms need to focus more on outcomes:
 - sometimes in relation to your customers collectively and sometimes in relation to your customers individually.
- Consumer Duty impacts product design and entire customer journey
- Must undertake initial review of your products and services
- May impact relationships with platforms/manufacturers/distributors etc



- Required to keep products and services under regular review
- Principles 6 and 7 are disapplied to the extent that Principle 12 applies
- New focus on whether you are providing 'fair value'
- More basis for regulatory enquiry and challenge
- Likely to drive increased monitoring/compliance burden

Application in Distribution Chains

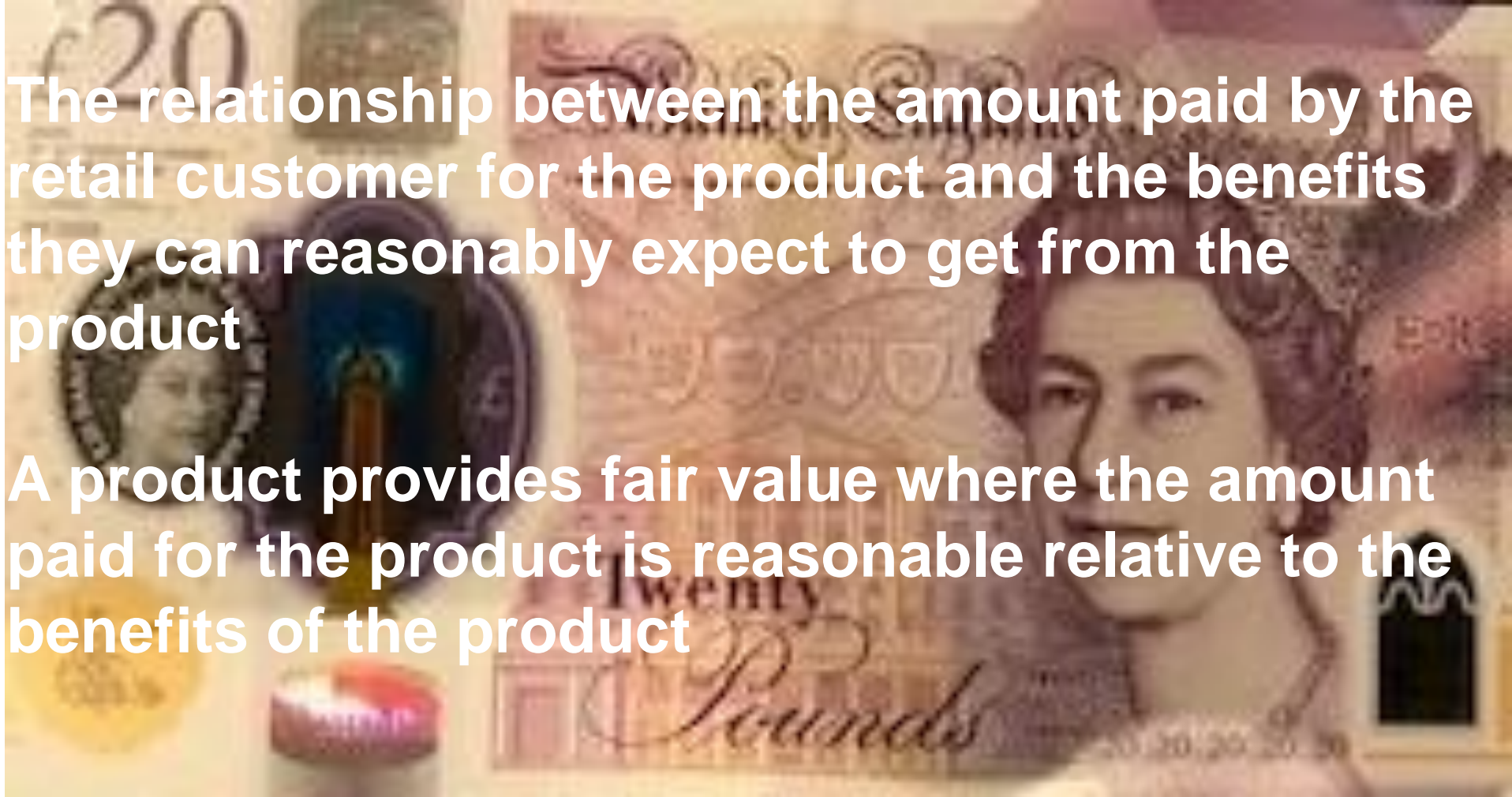
Do you agree or have any comments about our intention to apply the Consumer Duty to all firms engaging in regulated activities across the retail distribution chain, including where they do not have a direct customer relationship with the 'end user' of their product or service?

- Rules to apply proportionately, taking account of the firm's role in relation to the product or service, the nature of the product or service and the characteristics of consumers.
- All firms need to comply with the Consumer Duty for their own activities.
- Firms with a direct relationship with the end user to have the greatest responsibility under the Consumer Duty.
- Firms are not able to transfer their responsibilities to other firms.
- Wholesale firms in the distribution chain only caught if they have 'material influence' over design/operation of the product.
- Not applicable to unregulated firms in the distribution chain.
- Would apply to authorised firms approving financial promotions on behalf of unauthorised third parties.
- Applies to UK distributors of non-UK products and services on an 'all reasonable steps' basis

- FCA thematic review of distribution chains (TR 19/2) found that some firms were not focussing sufficiently on customer outcomes, particularly where multiple parties were involved in delivering GI products and services, impacting:
 - ✓ The process of selecting partners
 - ✓ Product development and manufacture
 - ✓ Product and service delivery
 - ✓ Oversight and monitoring
- E.g. *"Customers paying potentially excessive prices due to parties in the chain receiving remuneration which appeared to significantly exceed the costs incurred in distributing the products. This was most prevalent where insurance was linked to another non-financial purchase, such as a car or a holiday."*

Price and Value 1: What is value?

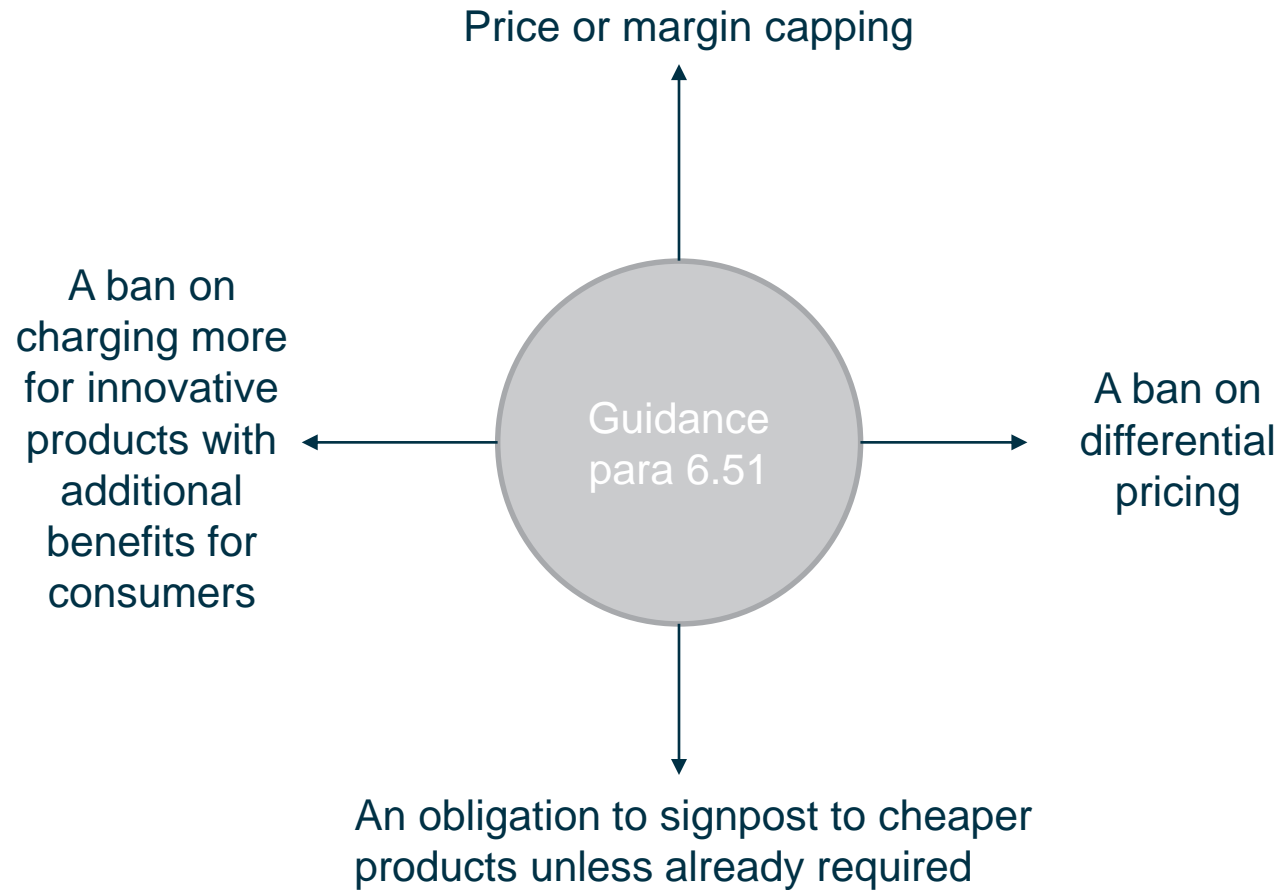
PRIN 2A.4.1R

The background of the slide is a composite image. On the right side, there is a large, slightly faded image of a British £20 banknote, showing the portrait of Queen Elizabeth II. On the left side, there is a smaller, more prominent image of a lit candle in a glass holder, with a flame. The candle is positioned in front of the banknote.

The relationship between the amount paid by the retail customer for the product and the benefits they can reasonably expect to get from the product

A product provides fair value where the amount paid for the product is reasonable relative to the benefits of the product

Price and Value 2: What this is *not*



Price and Value 3: Value assessment and issues

Value assessment – a required process

- Firms must be able to show the FCA their assessment
- It's not acceptable to rely on consumers to consider whether the price is right
- Factors include (* are the minimum):
 - Nature of the product and its benefits*
 - Limitations (e.g. exclusions)*
 - Expected total cost to retail customer*
 - Firm's costs, but note also "possible savings...which could be shared with customers"
 - Benefits and utility received by customers
 - Market prices
 - Possible returns
 - Assumptions on credit or other risks

Issues

- Interaction with Consumer Rights Act 2015 and (1) FCA guidance on variation clauses – this raises the bar for price increases; (2) impact on bank charges test case and contingent fees – need to consider total cost of the product over the lifecycle
- Non-financial costs
- Products with existing price caps have to comply with this outcome **as well** as the cap
- Impact of costs savings
- If a product is very profitable, how do you know if that's because it's popular, or unfair?
- Potential "waterbed effect" risk?



Demonstrating Compliance: Supervision and enforcement

"Almost all agreed that the Consumer Duty would succeed or fail based on how we supervise and enforce it"

FCA's new supervisory mindset:

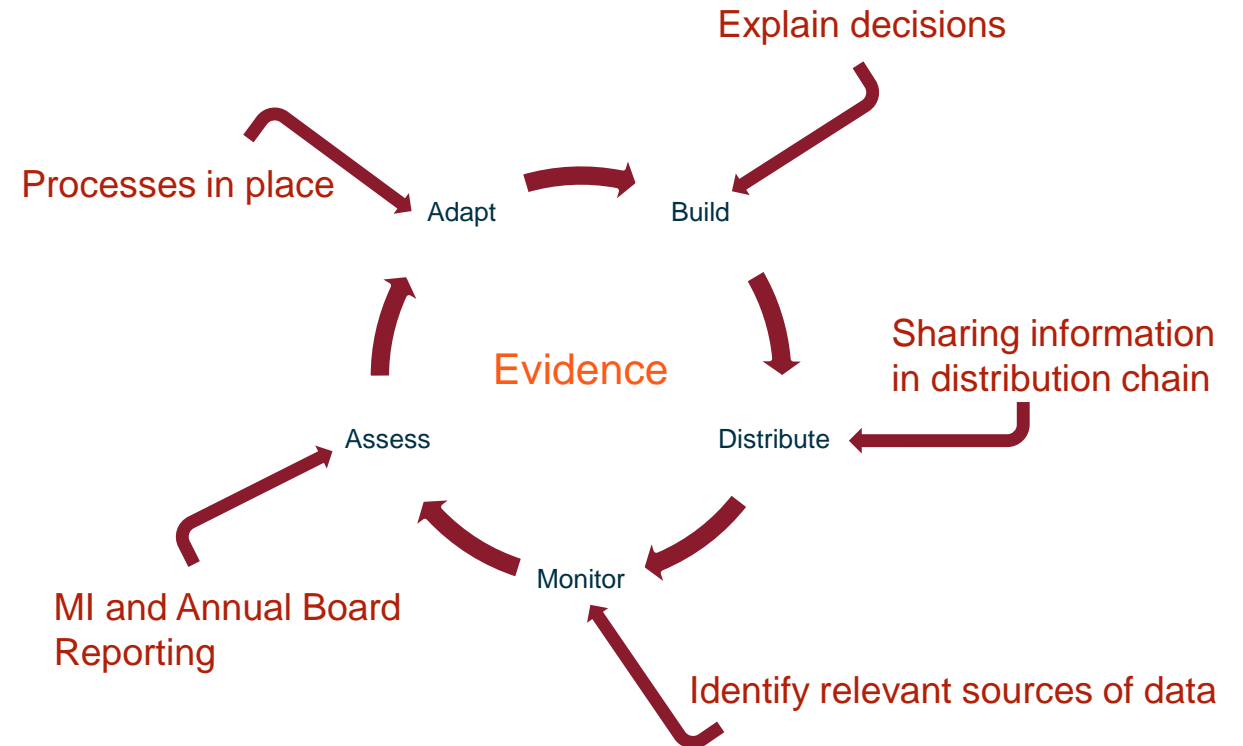
- "Assertive supervision"
- Focus on most serious misconduct
- Intervention before harmful practices become entrenched

"Firms can expect at every stage of the regulatory life cycle to be asked to demonstrate how their business models, the actions they have taken, and their culture are focussed on good consumer outcomes."

Monitoring throughout the lifecycle

"We do not propose to require firms to report on specific metrics, but firms need to ensure that they can demonstrate effectively how they are monitoring the outcomes that their customers receive, identifying harm or risk of harm and addressing the issues that they identify"

"...our existing record-keeping requirements set an expectation that firms have records that are sufficient to enable us to monitor the firm's compliance with the requirements under the regulatory system."



Demonstrating Compliance: Monitoring

"Acting reasonably"

"Appropriate Data"

- Data-led FCA
- Subjective outcomes and false expectations
- Customer engagement and engagement bias

Behavioural Insights

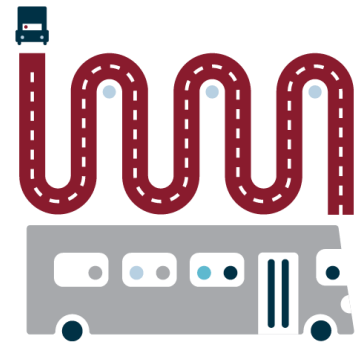
- Churn: not suitable or *unsuitable*?
- No complaints: The happy customer or the ill-informed customer?
- Cross-reporting on structural issues

Reporting / Root Cause Analysis

- Complaints Resourcing
- Complaints Reporting
- Board responsibility
- Sub-board reporting
- 'Speak-up' emphasis

Exit Poll Question: Which aspect of Consumer Duty compliance do you think will be the most challenging for your business?

- A. Our starting level of compliance
- B. Getting senior management buy-in
- C. Conducting a full review of our regulated business and ancillary activities
- D. Insufficient ongoing compliance resource



Any questions?



About Osborne Clarke

Our global connections and 'best friends'

Through a network of 'best friends' we extend our reach across the globe, particularly in North America, EMEA & Asia Pacific. We have worked closely with like-minded firms in over 100 countries. We'll find the right local partner for you and wherever that may be, we will make sure that you receive the Osborne Clarke level of service.

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talented lawyers

working with

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expert partners

in

25

international locations*

advising across

8

core sectors

with

1

client-centred approach

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