CP21/36: A New Consumer Duty

BSA response

15 February 2022

Building Societies Association

Introduction

The Building Societies Association (BSA) represents all 43 UK building societies, as well as 6 credit unions. Building societies have total assets of over £448 billion and, together with their subsidiaries, hold residential mortgages over £342 billion, 23% of the total outstanding in the UK. They hold over £316 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies account for 38% of all cash ISA balances. They employ approximately 43,000 full and part-time staff and operate through approximately 1,380 branches.

There are a lot of positives about the proposals in CP21/36……

We are pleased that:

1. There has been a withdrawal (for now) of proposals for a Private Right of Action.

2. The new principle is focussed on requiring firms to deliver good outcomes for retail customers.

3. There is an acknowledgement of the need for proportionality, although see our comments below.

4. Confirmation has been provided that the Consumer Duty will not apply in retrospect, but see our comments below.

5. There is an acceptance that fair value is about more than just price.

……Although we still have some concerns

Whilst acknowledging the positive steps taken by the FCA in response to feedback, we and our members continue to be concerned:

1. That the FCA continues to pursue these measures despite not yet having produced a meaningful Cost Benefit Analysis (CBA), which clearly articulates the benefits of the proposals. See our comments in response to Q19.

2. That in the absence of that CBA, the FCA is not in a position to demonstrate that these proposals will serve to allow it to achieve better outcomes for customers than it would be able to achieve under existing legislation and regulation, were it to more effectively supervise and enforce under them. We refer the FCA to our comments regarding this in our response to CP21/13.

3. At the extremely short implementation period for a set of measures that will require firms to complete root and branch reviews of end to end operations for both existing and closed books and governance, to name but a few.

4. That while there is a nod to proportionality throughout the CP, there is a real risk that adopting and maintaining the requirements it envisages will place disproportionate strain on smaller firms in particular both operationally and financially.

5. At the risk of misinterpretation, misapplication and potential retrospective application by the Financial Ombudsman Service (FOS) in relation to complaints against firms.

Response to Questions

Q1: Do you have any comments on the proposed scope of the Consumer Duty?

The proposed approach of aligning the scope of the duty with the existing scope of sectoral sourcebooks is sensible, as is the proposal to apply it to prospective customers. In particular, the latter will ensure that firms are required to act consistently with the duty across the product lifecycle.

In relation to the non-Handbook guidance contained in Appendix 2 S2.8, it would be helpful if the FCA were to provide further guidance on its expectations of firms around what they are expected to do for individual customers to ensure understanding. This would be helpful in the context of some of the reassurances that the FCA has given regarding the responsibilities of consumers themselves in relation to the application of the duty.

Q2: Do you have any comments on the proposed application of the Consumer Duty through the distribution chain and on the related draft rules and non-Handbook guidance

We continue to agree with the proposed application of the duty through the distribution chain.

We remain concerned, however, that despite the additional guidance, the level of oversight required of firms to satisfy the duty may result in innovation being stifled and rising costs leading to those costs being passed on to consumers or from firms withdrawing from offering certain products, with a consequential impact on competition. We highlighted these risks in our response to CP21/13 and the FCA has failed to comprehensively address those concerns in CP21/36.

Q3: Do you have any comments on the proposed application of the Consumer Duty to existing products and services, and on the related draft rules and non-Handbook guidance?

While the FCA ***states*** that the duty would not apply retrospectively to past business and therefore not to firms' past actions, the reality is that the duty has been framed in such a way that ***retrospective application is a very real risk*** for firms. We remain extremely concerned at the expectation that this creates of firms, and at the risk of misinterpretation, misapplication and retrospection of the duty, particularly from the FOS.

This is particularly the case given the drafting of PRIN 2A.3.5 R, which effectively does require firms to assess and review matters in relation to closed customers in accordance with the standards of the new Duty. We understand the rationale for that, but in our view this creates a risk that in considering complaints relating to such products, the FOS (and others) may seek to apply today's standards retrospectively.

To allay concerns in that regard, the FCA has pointed to a number of factors, including the approach taken by it and the FOS to cases with wider implications. However, given that the new approach to dealing with such cases is yet to be tested, this provides cold comfort.

We therefore urge the FCA to do more to provide comfort and give clarity to firms and others tasked with interpreting the requirements of the duty. For example, consider including further provisions in the Handbook Rules and Guidance that would put beyond doubt the fact that the standards should not be applied retrospectively. The FCA should consider whether there is

scope to address this through changes to DISP or to the Memorandum of Understanding with the FOS, for example.

Q4: Are there any obstacles that would prevent firms form following our proposed approach to applying the Consumer Duty to existing products and services?

The primary obstacle we see here is the application of data protection law.

For example, how does the FCA intend its proposed rules to interact with existing guidance from the ICO regarding marketing? There are also potential issues for firms in the processing of sensitive customer data.

Unless these potential points of tension/misalignment are properly identified, explored and a workable approach arrived at, the ability of firms to meet the spirit and requirements of the new duty could be hampered.

If it has not already done so, the FCA needs to liaise closely with the ICO to ensure that their position and expectations are aligned.

Q5: Do you have any comments on the proposed Consumer Principle and the related draft rules and non-Handbook guidance?

We think that the FCA's proposed principle better reflects the overall standard of behaviour that is expected of firms, and agree that it is developed by the other aspects of the Duty. Further, the wording of the new principle has been constructed in such a way as to make it more likely that it will achieve the FCA's aims in a proportionate manner, as opposed to the other wording that was mooted in CP21/13. We have the following comments:

- ***Clarity:*** In our response to CP21/13, we pointed out that there is a need for clarity over the application of the duty in areas where existing legislation/regulation requires firms to apply controls or to approach things in a manner that may not always generate good customer outcomes. See, for example, our comments regarding requirements under existing data protection law in our response to Q4 above. It would be helpful if the FCA could provide further clarification on this point in its guidance.
- ***Objectivity:*** Creating an objective standard based on the concept of how a reasonable firm would act is helpful to some extent, but we are concerned about how this objective standard might be interpreted, particularly by the FOS. It would be more helpful were the FCA to clearly state that in the event of actual or potential conflict with legislation or detailed regulation (including its own) the legislation or detailed regulation takes priority.
- ***Reasonableness:*** The FCA says its focus is on firms acting reasonably to deliver good outcomes and that the cross-cutting rules and guidance set out how they should act to do that. The more examples that the FCA can provide as to what might constitute reasonable behaviour in particular circumstances the better.
- ***Proportionality:*** Many building societies and credit unions are relatively small, non-complex organisations with limited resources. While the CP talks about proportionality and firms taking a risk-based approach, some of the requirements do not feel optional – for example, some of the proposed requirements around assessing whether products and services are designed to meet the needs of consumers etc. We would like the FCA to provide greater clarity on exactly how it will ensure that it (and perhaps more importantly the FOS) takes a proportionate approach when assessing how firms have implemented the new requirements.

Q6: Do you agree with our proposal to dis-apply Principles 6 & 7 where the Consumer Duty applies?

We agree with the concept of disapplying Principles 6 & 7 where the new Duty applies.

Q7: Do you agree with our proposal to retain Handbook and non-Handbook material related to Principles 6 & 7 should remain relevant to firms considering their obligations under the Consumer Duty?

In order for us to be sure of this, the proposed guidance needs to explain that:

- The consumer principle imposes a higher standard of conduct than Principles 6 & 7
- While existing guidance on Principles 6 & 7 will remain relevant to firms in considering their obligations under the Consumer Duty, firms should take account of the inherent limits of such guidance as they do not cover FCA expectations under the new Duty in full
- Failure to act in accordance with existing guidance on Principles 6 & 7 and which would have amounted to a breach of those Principles is likely to amount to a breach of the Consumer Duty
- Where a firm is acting in accordance with guidance on Principles 6 & 7, this should not be relied upon alone in considering how to comply with the Consumer Duty. Firms will also need to consider all their obligations not only under the Principles but under any other applicable FCA rules

It is disappointing that the FCA does not consider that the review of the Handbook which would help achieve the clarity that both firms and consumer should have is urgent enough to delay implementing the duty. We remain concerned that "a regime which operates on the basis that one set of principles may be applied unless another is applicable, is fraught with the risk of confusion and overlap, with firms and consumers unclear where one set of obligations ends and another starts".

We do note that the FCA has said it will use the implementation period to identify any areas that may require amendment in light of the duty. In our view this is wholly inadequate. It is critical that if Principles 6 & 7 are to remain, the FCA must carry out its own robust exercise to ensure that it identifies and removes any areas of potential or actual overlap, inconsistency or conflict. Perhaps the FCA could use any extended implementation period to complete this work, make necessary amendments and thus provide the necessary clarity to regulators, firms and consumers alike.

Q8: Do you have any comments on our proposed cross-cutting rules and the related draft rules and non-Handbook guidance?

In our view, the proposed rules are broadly workable and serve to support the new principle. Removing the specific cross-cutting rule relating to consumers in vulnerable circumstances is sensible, as is the approach of embedding consideration of these consumers at every part of the customer journey.

We are pleased that:

- The FCA recognises and has addressed the fact that referring to firms having to "take all reasonable steps" is not the best way to achieve the aims of the new Duty. This ought to remove the sense of complying with rules and rigid processes and encourage firms to act reasonably *per se*.

- The FCA has acknowledged that, in the context of foreseeable harm, the cross-cutting rules do not require firms to protect customers from unforeseeable harm, all poor outcomes or risks that the customer reasonably understood and accepted. The regulator's focus on firms addressing harm only when it is reasonably foreseeable is welcome, ***although we remain concerned as to how that might be interpreted and applied in the context of disputes. We refer to our comments earlier around FOS interpretation and the necessity of having in place an effective process for dealing with wider implications cases in this context.***

While we think that the draft rules and Handbook guidance broadly reflect the FCA's position as set out in CP21/36, more clarity over expectations in general would be helpful. For example:

- The circumstances in which harm would be considered foreseeable and the action required as a result of that is not currently clearly defined, and in our view they should be.
- The CP states at Paragraph 6.26 that "if a harm were not foreseeable at the outset, but later became foreseeable, we would expect firms to take the appropriate action". It would be helpful if the FCA could clarify whether, in circumstances where a firm did become aware of such a situation, the FCA's expectation would be that the firm would need to address any issue retrospectively or whether it should simply do so for the future. On the basis that the Duty is not intended to be applied retrospectively, we would expect the latter to be the case, but clarity on the point is important for firms and for setting consumer expectations.
- We note that the current drafting no longer refers to the foreseeable harm having been "caused" by the firm. We believe that the rule should be constructed so as to include reference to causing of harm as opposed to harm that may arise by other means, such as the customer's own action/inaction. What harm is being referred to? Harm to the target market, or to an individual customer?
- We are pleased to see that the guidance in PRIN 2A.1.10 G clarifies the position regarding creation of a fiduciary duty.
- In PRIN 2A.2.17 G there is benefit in expanding the wording to say "the same or similar *product*".

Q9: Do you have any comments on our proposed requirements under the products and services outcome and the related draft rules and non-Handbook guidance?

We remain of the view that the overall aim of ensuring that all products and services that are sold to consumers are fit for purpose, designed to meet consumers' needs and targeted at the customers whose needs they are designed to meet is appropriate.

Setting different requirements for manufacturers and distributors of products makes sense, as do the proposed requirements for each. Please see our comments above relating to the potential for retrospective application of requirements in PRIN2A.3.5 R in response to Q3.

We agree that the rules supporting the products and services outcome have been drafted in such a way as to effectively underpin it and they reflect the FCA's position in CP21/36. We have the following further comments on the detailed rules and guidance:

- PRIN 2A.3.17 R (1) refers to "detriment". For consistency with other aspects of the new rules, consider whether this should refer instead to "foreseeable harm".
- PRIN 2A.3.22 R is limited in only referring to relevant "sales" information. The FCA should consider whether this should be expanded to include other information, such as cancellation rates.

- In relation to PRIN 2A.3.28, please see our comments above in response to Q5 regarding which standard prevails in the event of perceived conflict between detailed requirements in other parts of the Handbook and the Principle. As stated previously, it may be worth considering a general provision which gives clarity on this if, in all cases, the detailed rules should be prioritised.

Q10: Do you have any comments on our proposed requirements under the price and value outcome and the related draft rules and non-Handbook guidance?

We are pleased that the FCA does not propose that firms should charge the same price to all consumers and that differential pricing is not necessarily excluded. We particularly welcome the clear acknowledgement that fair value is about more than just price.

We agree that the rules supporting the price and value outcome have been drafted in such a way as to effectively underpin it and they reflect the FCA's position in CP21/36. In terms of assessing Fair Value it would be helpful to have more detailed examples of good and bad practice. This would allow firms to apply a set of parameters to the general considerations provided by the FCA, which would lead to a more accurate and consistent value assessment result.

We have the following further comments on the detailed rules and guidance:

- The rules do not set detailed requirements for the fair value assessment and instead set out a number of factors that firms must consider, as a minimum, in assessing value. While this does provide firms with scope to make their own assessment based on guidance, is it the FCA's intention to introduce further factors and/or share (as time goes on) examples of good and bad practice it observes within the bounds of these minimum requirements? To do so would be extremely helpful.
- The wording at PRIN2A.4.11 G (3) suggests that where a firm achieves savings and benefits from economies of scale, these should be shared with retail customers and that failure to do so may suggest that the product is not fair value. We are concerned that this is a price intervention with implications for competition and will remove any incentive to achieve such savings and benefits. The FCA's intent here should be made clear.
- As the FCA is aware, price variations can legitimately occur for a variety of reasons including pricing for risk and service differentiation. The FCA should make it clear that those and other accepted reasons for price variation are permissible under the Duty.

Q11: Do you have any comments on our proposed requirements under the consumer understanding outcome and the related draft rules and non-Handbook guidance?

We agree with the FCA's decision to rename (and thus to some extent re-focus) this outcome to concentrate on customer understanding. However, we remain concerned at the risk that regulatory expectations in this area create a disproportionate impact on smaller firms in terms of cost particularly. For example, in PRIN 2A.5.5G, in the context of complex financial products, including mortgages, despite the terms of (e), does the FCA recognise the risk that in order to properly ensure understanding firms may in fact be pushed into providing customers with *more* information? In addition, other legislative/regulatory requirements that demand the provision of sizeable amounts of information in a prescribed form have the potential to adversely impact understanding – the CCA and the PSRs being just 2 examples.

We are pleased that the FCA recognises that firms' approach to testing and establishing customer understanding will reflect their capabilities and resources. While the FCA states that it expects the testing to be "proportionate" more guidance on exactly what that might mean for smaller firms in particular would be useful. Clarity over the regulator's expectations as to what it expects from firms in terms of testing customers' understanding generally – can it provide more guidance based on, for example, the scale of a firm and its resources?

We agree that the rules supporting the customer understanding outcome have been drafted in such a way as to effectively underpin it and reflect the FCA's position in CP21/36. We have the following further comment on the detailed rules and guidance:

- PRIN 2A.5.8R requires firms to test "communications" in advance. Given that communications are expressed at PRIN 2A.5.1R (3) as including verbal communications, the FCA should consider whether the words "in so far as possible" or similar should be added to 2A.5.8R at least in relation to verbal communications.

Q12: Do you have any comments on our proposed requirements under the consumer support outcome and the related draft rules and non-Handbook guidance?

As with the customer understanding outcome, we agree with the FCA's proposed wording change that would focus more directly on their desired outcome. We also welcome the change of emphasis from "undue hindrance" to "unreasonable barriers" and the greater clarity achieved by describing the barriers as "those which frustrate the customers' use of the product or service without reasonable explanation".

We agree that the rules supporting the customer support outcome have been drafted in such a way as to effectively underpin it and reflect the FCA's position as set out in CP21/36. We have the following further comments on the detailed rules and guidance:

- In the context of PRIN 2A.6.3G(1), how does the FCA see the point relating to situations where a customer is unreasonably required to provide personal data and grant permission to use it sitting in the context of what it may ultimately require of firms from a Diversity and Inclusion perspective? We think that care needs to be taken in how this provision is constructed, and it may be that the wording just needs to be clarified.

Q13: Do you think the draft rules and related non-Handbook guidance do enough to ensure firms consider the diverse needs of consumers?

Yes, in conjunction with the FCA's existing rules and guidance in this area. In addition to our comments above in relation to the draft rules, and the concerns we raise at the outset of this response regarding proportionality given the rule requirements, we have the following additional comment:

- Per our comment above in relation to Q8 on the products and services outcome, there may be benefit in expanding the wording to say "the same or similar *product*".

Q14: Do you have views on the desirability of the further potential changes outlined in paragraph 11.19?

In our view further consultation on the interaction between diversity characteristics and the current definition of what constitutes vulnerability would be useful. Perhaps that could be done as part of the planned Q2 2022 consultation on diversity and inclusion.

Q15: Do you agree with our proposals not to attach a private right of action to any aspects of the Consumer Duty at this time?

Yes. Although we would prefer they were completely abandoned for all the reasons articulated in our response to CP 21/13, which you can access through this LINK.

We consider it important for the FCA to acknowledge that a further consultation, including completion of a robust CBA, should be undertaken before any move is made to introduce a private right of action in the future.

It would also be useful for the FCA to set out now the circumstances in which it might consider it appropriate to reconsider introducing such a right.

Q16: Do you have any comments on our proposed implementation timetable?

This area of the consultation generated much concern from our members. In short, consensus is that given the nature of what the Consumer Duty will require of firms, the implementation period being proposed is totally unrealistic. After discussion with members, the consensus is that a time period of at least 2 years from the date that final rules are published is required.

Our members are understandably concerned as to their ability to complete substantial amounts of work during the currently short implementation period. The following were referenced in particular:

- The amount of work required to review, assess and make changes in relation to live legacy books should not be underestimated.
- The difficulty of comprehensively mapping customer journeys at the same time as other major change programmes.
- Reviewing and in some cases re-negotiating 3rd party contracts (including intermediary and broker agreements).
- Review of terms and conditions and customer-facing documentation.
- Website reviews and updates.
- Review and potential updating of customer testing.
- Development of oversight plans.
- Development of MI/reporting (including potential systems changes).

We and our members very much welcome the FCA's keenness to work with firms, trade bodies and wider stakeholders during the implementation period. We agree that this sort of engagement, done effectively, can help identify good and bad practice and inform other stakeholders. We would welcome further direct dialogue with the FCA in this context.

Q17: Do you have any comments on our proposed approach to monitoring the Consumer Duty and the related draft rules and non-Handbook guidance?

The proposals as to how firms should monitor the Consumer Duty are reasonable overall, although we again remain concerned at the potentially disproportionate impact these requirements may have on smaller firms in particular. As we said in response to CP21/13, there is a real risk that the overall impact of introducing these measures may ultimately lead to firms withdrawing from certain products, a stifling of innovation and a direct impact on competition.

From a governance perspective, we understand the need for Board oversight of how the Duty is being complied with, particularly as the Consumer Duty is constituted by a Principle. However, we think that allowing firms the latitude to have that oversight performed at a Board Committee could be useful in practical terms. We do not believe that an ability to do that would in any way deflect from the Board's responsibility regarding compliance with a regulatory Principle.

The need for management information and reporting is recognised, and the FCA's approach of allowing flexibility for firms to determine what is appropriate is helpful, and proportionate. We are concerned, however, that as the FCA seeks to adopt a more data-driven approach to supervision, this puts increased demands on firms to collect data that they might not otherwise collect, or to require them to collect and report data in a particular way, with the associated cost implications. It would be helpful if the FCA could provide clarity on what data firms will be expected to obtain and also how they might be expected to obtain, retain and report it. While the consultation does give examples of types of data / MI firms may wish to obtain, given the lack of clarity on expectations to support the data led approach, a risk exists that scarce resources could be utilised developing MI which may not meet with expectations.

The FCA's current supervisory arrangements mean that all bar the very biggest building society do not have a dedicated supervisor. More clarity would be helpful as to how the FCA will engage with firms:

- During the implementation period (ie from now until March 2023) to ensure that, for example, a consistent approach is taken to interpreting the requirements, and
- After the implementation period, to ensure, for example, that those firms that do not have a direct supervisor are not disadvantaged.

Q18: Do you have any comments on our proposal to amend the individual conduct rules in COCON and the related draft rule and non-Handbook guidance?

We believe that in order to fully embed the duty, making the proposed changes to COCON is necessary, as are the training requirements on firms. However, it would be helpful if the FCA could provide more background on the rationale for its proposal to dis-apply existing Conduct Rule 4. We are concerned that doing this may ultimately drive a different (and potentially undesirable) approach to conduct rule breaches.

Q19: Do you have any comments on our cost benefit analysis?

We are disappointed at the cost benefit analysis. While it *may* technically meet the requirements of a CBA, in our view it falls significantly short in terms of clearly and accurately setting out the benefits that such a duty will bring, without more effective supervision and enforcement. Much is based on assertion and it is not data or evidence-led, which calls into question the overall claim that "our judgment is that the proposals will be net beneficial." For such a major reform we would expect a more robust CBA - at the moment, the claimed harms are not substantiated. Indeed, the current consultation on the Future Regulatory Framework emphasises the need to ensure that robust and defendable CBAs are completed. This falls far from meeting that expectation.

Further, the FCA asserts that it expects the benefit to be significant because of the scale of the market and the large scale of harm addressed in specific previous market interventions. In relation to these:

- ***Scale of the Market:*** While any estimate of the harm across all retail markets would of course be inherently uncertain, the claim that the massive scale of the sector means that the scale of the benefit would be large doesn't necessarily follow. At some point the FCA must surely need to try to quantify the harm that is being addressed, or it will be unable to ascertain whether the Consumer Duty is a success in the future. There is a significant gap in understanding the drivers of the greatest quantum of harm, and therefore where reform can be focused most effectively.

This absence of data on where the most significant harms arise biases the assessment in favour of a general consumer duty rather than targeted action under the current rules, which may ultimately have achieved the same result.

- ***Previous Market Interventions:*** The FCA points to large scale harm that has been addressed through previous interventions as supporting the need to introduce the new Duty. However, instead of implying that these are representative of financial services as a whole, it may have been better to acknowledge that these were egregious cases and not in fact representative.

While the CBA does count the £ cost of time to understand and implement the Consumer Duty, we do not believe that it recognises the opportunity cost of what other projects businesses will have postponed or delayed because of this implementation, particularly over a proposed short 9 month implementation period. The FCA dismisses concerns about unintended consequences, especially from uncertainty about FOS interpretation, without acknowledging that these won't be observable until the Duty is in force. This creates a risk that firms take a very conservative approach and therefore the implementation and opportunity costs will be even greater. Besides, given the scale and scope of the proposals, we think that the risk of unintended consequences is too easily dismissed by the FCA.

Q20: Do you have any other comments on the draft non-Handbook guidance?

Our comments are mainly included in our responses to the other questions, further comments are as follows:

- While the examples given throughout the guidance (eg at 4.15 on what might demonstrate not acting in good faith), as always the more examples that can be provided the better. We welcome the FCA's plans to ensure that the guidance is added to, although it would be helpful to initially have more examples focussed on savings and mortgages products.
- At 2.3, it would be helpful to confirm specifically whether Consumer BTL (as brought in by EU MCD) falls under the new Duty. We have already had queries from members seeking clarity on the point.
- Confirmation on the Consumer Duty expectations in relation to third party referrals for products and services where the firm is not directly involved in providing those would be welcomed. It is currently unclear how the Consumer Duty requirements apply, for example, in circumstances where there is a customer referral to a third party providing home insurance cover or a referral to a firm for the provision of independent financial advice.

Q21: Can you suggest any other examples you consider would be useful to include in the draft non-Handbook guidance?

None.

By Elaine Morton
Head of Legal, Conduct Risk & Compliance
elaine.morton@bsa.org.uk
0207 520 5915

York House
23 Kingsway
London WC2B 6UJ

020 7520 5900
@BSABuildingSocs
www.bsa.org.uk

www.bsa.org.uk

The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £435 billion, and account for 23% of the UK mortgage market and 17% of the UK savings market.