ICAEW
REPRESENTATION 73/21

A NEW CONSUMER DUTY CP21/13*

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ICAEW welcomes the opportunity to comment on 'A new Consumer Duty' published by the Financial Conduct Authority (FCA) on 14 May 2021, a copy of which is available from this link.

We have not responded specifically to the FCA's questions in Annex 1 but the substance of our response reflects our thoughts on questions 25 and 26, and whether the new duty will have the intended benefits and/or whether there is the risk of unintended consequences.

This response of 31 July 2021 has been prepared by the ICAEW Financial Services Faculty. As a leading centre for thought leadership on financial services, the faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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EXECUTIVE SUMMARY

1. The FCA is seeking to raise the bar and we very much welcome this. We can see what the FCA is seeking to do and fully support getting a better outcome for the UK's 50 million consumers. In the past, UK consumers have not always got the products they need or outcomes they expect, and a number of firms have not historically acted in accordance with the FCA's principles.
2. We also welcome the FCA's plans to adopt workable and proportionate rules.
3. A competitive market can also act, sometimes, as a barrier to good consumer outcomes. There can be a first mover disadvantage, for example a loss of market share for the first bank to abandon free-in-credit banking, so a regulatory intervention or rule change can be the right tool to remove that first mover disadvantage.

Higher costs are worth it

4. We appreciate that higher standards may indeed increase costs, which could then be passed on to consumers. However, that may be a more sustainable outcome as lower prices based on unfair treatment would simply result in high costs from consumer harm and high redress or remediation costs. We support a world of fair business models.

The new Duty will require big change

5. The proposal will require a significant shift in culture and behaviour for UK firms. To respond to this, FCA Supervision staff will also need to be ready for more strategic level conversations with regulated firms. To its credit the FCA is in full recognition of the impending challenges and how its 'internal capabilities' and 'ways of working' will need to adapt (paragraph I, page 14 of A new Consumer Duty)'
6. Changes at firms are needed if the FCA is to achieve its aim of moving beyond where Principle Six and Principle Seven have taken us. As well conceived and drafted as those two Principles are, we continue to see firms take advantage of biases, information asymmetries, and business models whose profits depend on customers making poor choices. Firms will therefore need to assess outcomes on an ongoing basis, and not just at the start.
7. We think it is right that this consultation is causing waves in the industry and seeking to address the longstanding issues of 'sludge practices'. If firms are making it difficult for UK consumers to do the very things that are in their best interest, then that can't be a practice we nor the regulators should endorse.

ICAEW Feedback

8. There is much to applaud in the FCA proposals, but our questions are around clarity and practicality. There are five aspects of the proposals where more consideration may support good and efficient outcomes:
    a) There is a lack of clarity around what precisely this new Duty will mean in practice and how high the FCA is actually setting the bar. Further, there is a consequent lack of clarity around what firms need to do to raise the bar to the appropriate extent. The Rules need to be enforceable and more specificity will be needed in future consultations so that firms do not face 'hindsight risk' and understand ex ante, where enforcement action will be taken.
    b) There is also a question as to whether the proposals outlined in the consultation are the best way to achieve a 'raising of the bar'. New rules can lead to a 'tick box' approach if firms generate management information and evidence trails simply to support current practices. Instead, the FCA already has a range of existing tools and powers at its disposal that it could use differently. The same (or superior) outcomes might be achieved, at lower cost too, if the FCA sought to enhance its strategy on Supervision and Enforcement resourcing and their ways of working. Supervision and

Enforcement could act at a strategic level and take a holistic approach in their conversations with regulated firms.

c) A ‘raised bar’ means regulated firms inevitably face a heightened risk of misconduct as more practices and behaviours risk being found wanting. Therefore, some regulated firms may seek to de-risk the degree of conduct risk their business is exposed to. For example, on product lines where their profits are lower they may reduce service provision and this may fall most heavily on vulnerable customers, those from lower income groups, or on those who are less wealthy. If the new consumer duty requirements result in regulated firms exiting the market, due to a lack of clarity or a perception of regulatory hindsight, customers could turn to unregulated sources of credit or simply go un-serviced, which could in turn lead to significantly more consumer harm.

d) The cost of compliance to firms of changes to pricing and specifically elimination of the loyalty tax, could have a material impact on the business models and the viability of many firms, large and small. Again, some good firms may exit and leave poorer customers and those who are most vulnerable, un-serviced.

e) The Private Right Of Action (PROA) could mean the FCA finds more of its decisions being brought into question if court rulings go on to set where the ‘bar’ is for regulated firms and how they therefore organise themselves.

Market provision

9. Whilst we welcome the FCA’s intent to ‘raise the bar’, our points under c. and d. highlight the potential material impact on market provision. The FCA may need to reflect on a way to achieve a ‘raising of the bar’ but in a way which also continues to give consumers choice and access to a wide range of financial services products. Under point b. above we suggest one of the ways through which that might be achieved.

PROPOSED ACTIONS

In order to mitigate the five risks above, we encourage the FCA to consider the following set of actions:

Risk to FCA's objective	Proposed mitigating action
I. There is a lack of clarity around how firms might address the FCA's expectations.	A. When the FCA makes their second consultation, we would expect them to make clear the interplay of a Consumer Duty with the existing Principles and TCF outcomes, conduct questions and vulnerable customers paper, GI pricing paper and the value in funds paper.
	B. The FCA could usefully clarify, based on past markets that they have acted on, how they would have operated if the new Duty had existed. They could use some worked examples and case studies to illustrate how the Duty and supporting Rules would have been used by the FCA.
II. If implemented, the consultation's proposals may not achieve their aim and the FCA might achieve them more expediently through existing tools and resources.	C. The FCA to do a Cost Benefit Analysis of the proposals including scenarios that assess the impact of firms potentially withdrawing from servicing certain consumer groups/profiles.
	D. The FCA to assess counter proposal of targeting the same outcomes but through the use of the FCA's competition powers and/or more robust and strategic Supervision and Enforcement deployment.
	E. The FCA to set out its budget, resourcing plans and KPIs (eg, no. of Supervision and Enforcement staff recruited, skills gap assessment of FCA staff, no. of open enforcement fines and Enforcement notices p.a.) for its Supervision and Enforcement teams, as it 'gears up' for the implementation of the new Duty.
III. If regulated firms de-risk their books, we could see consumers are left with no access to important products and services.	F. As above, the FCA to do a Cost benefit Analysis to look at, among other things, the cost of the new controls that will be needed from regulated firms.
	G. The FCA to do scenario planning/analysis on what the impact could be if firms do withdraw. Use FCA behavioural team to assess the likely market reaction to new proposals (including new players).
	H. Building on their Financial Lives Survey, the FCA to publish analysis of UK financial capability, so firms might reflect on the challenges of recognising whether their communications are 'understandable'.
IV. The FCA's proposals on the loyalty tax will have material business model impacts which could, again, impact service provision for consumers.	I. FCA to do or reuse their business model analyses to quantify the impact of the pricing changes on firms and markets. The FCA could look at past business model analyses undertaken by FCA staff and those done by the Prudential Regulation Authority, to understand where firms make money and specifically the portion from loyalty taxes.
	J. The FCA to evaluate the success or not of previous interventions on market pricing and the impact on service provision for consumers.

MAJOR POINTS

I – LACK OF CLARITY

1. We think there is a lack of clarity around what precisely the new Duty will mean in practice. At a high level we have seen a wide range of reactions from regulated firms in response to the FCA's consultation. Some see the new Duty as 'ground-breaking', describe it as one of their biggest projects but at the same time, others say it is simply 'more of the same'. These respective responses could reflect the relative position of different firms and how much work they each might need to do. But it could also reflect a lack of clarity in the FCA's first consultation. If the UK's largest players, with the resources of experienced regulatory affairs teams have very different interpretations of the same FCA consultation, then looking at outcomes, the FCA's consultation may not be clear or understood.
2. The FCA has expressed the idea that responsibility for the new Duty should not sit in compliance teams but should instead have Boardroom ownership. Given the divergent views from firms, expressed above, we are not sure this sentiment comes across to all firms consistently. The FCA have said the new Duty 'will require a significant shift in the culture and behaviour' of firms but as above, this may not have been understood clearly by all firms.
3. In terms of specifics, the proposals set out a number of places where the interpretation is ambiguous and at least not clear at this stage and before the FCA's second consultation. What exactly does the FCA's language mean in terms of raising the bar and secondly how might regulated firms demonstrate or assess that they are meeting that standard is not yet clear (See Actions A and B)
4. As the new rules and guidance are non-specific (to allow for proportionate responses), this inevitably makes it less clear to firms what they need to do. Some examples where more exposition would help include:
   a) The second consultation should set out what work regulated firms will need to do to benchmark and assess their conduct framework. For example, how do firms benchmark their product governance or communications?
   b) We are aware this will be settled in the second consultation, but at this stage it is unclear how the new Duty will interact with the existing Rules and Principles eg, will existing Principles 6 & 7 be disapplied or not? Ideally, if we are talking about the important topic of customer interest, we should have one set of wording to say what firms' customer responsibility is. It is confusing as currently set out and we think the new Duty should replace Principles 6 and 7.
   c) There is the risk that the 'best interest' wording could be seen as a real fiduciary responsibility to clients; despite the FCA assurances to the contrary.
   d) The proposal's cross-cutting rules will need to be further clarified. We would find it helpful if the second consultation could set out how the practical implementation of cross cutting rules might work.
   e) Firms will face the challenge of assessing terms like 'reasonableness'. The term is deliberately non-specific and that allows firms to implement proportionate responses, but firms still may face the risk that the regulator may second guess their decision.
5. The lack of clarity at this stage could become very critical when it comes to matters of enforcement. In due course, the regulator will need to have the clarity to enforce against its new Duty and Rules. The FCA's second consultation should usefully address this risk and remove the uncertainty. This will support firms and consumers understanding of fairness and make the new approach more predictable in terms of the regulatory reaction function. The FCA's second consultation should usefully address this risk and remove the uncertainty.

II – FCA CAN USE EXISTING TOOLS

1. The FCA is seeking to raise the bar. However, at the same time most of what it is seeking to do is set out in existing FCA rules and regulations. So, it is unclear if using its rule making powers (to write new Rules and a new Principle) will deliver the outcome the FCA seeks.
2. Instead, the FCA might use its existing regulatory toolkit and resources especially as the FCA has suggested its core supervision model will stay broadly the same. So more simply and more quickly, with less opacity and less costs, the FCA could change the frequency and intensity of its Supervision and Enforcement deployment. Further, there are elements of the extant regulatory architecture that could be leveraged to deliver good outcomes, not least through the Senior Managers and Certification Regime. The FCA could:
   - Dialogue with SMCR individuals on how customer outcomes are considered in their particular areas of responsibility.
   - The FCA could assess board packs and discuss with individual board members how they consider the totality of the firm's work to achieve good consumer outcomes.
3. The FCA, and its predecessor organisation the FSA, have made past attempts to change regulated firms' approach to conduct. It may be helpful to reflect on the tools that have been successful and the tools that have not. On reflection and from a practical perspective, it is not clear if the stratagem of rule-writing has been consistently successful in the recent past. (See Actions C, D and E)
4. Arguably, firms and people generally listen far more and respond more directly to what people 'do', than what they might 'say'. Such an argument would support the case for the FCA deploying its Supervision and Enforcement resources with a different intent, instead of writing new rules. We look forward to seeing the FCA's 'gearing up' plans in the Supervision and Enforcement areas, alongside the second consultation. The FCA will need to ensure there is a framework around these new emboldened teams that delivers a consistency that does not adversely impact competition in UK financial services.
5. A change to FCA Supervision and Enforcement, instead of new rules, would also lead to lower relative costs to the industry and therefore to customers. With new rules, regulated firms may implement costly checking processes which might achieve little, but which do 'tick the box' and demonstrate a firm has taken the required 'reasonable' steps. With a change to FCA Supervision and Enforcement, instead of new rules, regulated firms would implement efficiently the checks to avoid poor customer outcomes and therefore FCA Supervision and Enforcement interventions: the same events that the FCA would be most concerned about.

III – REGULATED FIRMS MAY DE-RISK

1. 'Raising the bar', if achieved, will provide better protection for retail consumers. However, the expectation on firms to take all 'reasonable' steps to avoid misconduct could create an intolerable level of regulatory risk that could drive even good firms out of the industry and/or reduce service provision to consumers; in particular those who are more vulnerable or from poorer backgrounds.
2. Some firms will exit the market because they have a focus on profitability and not on the customer. For example, some newer firms will have aggressive growth plans to enable them to deliver on targeted profits and other performance deliverables. Such firms are a function of a diverse and competitive economy. Further, the profit motive is necessary in capital markets to drive return.
3. The effect of the extra checks and controls means regulated firms will need to implement or to demonstrate they are meeting the new higher standards. However, there is the risk that this could lead to adverse competition outcomes. The burden of extra controls might be met by larger firms with their economies of scale but could be more challenging for smaller firms to implement and evidence. The rules may fall most harshly on small and mid-tier firms who may not know if they are doing enough in certain areas.
4. Smaller firm will have a lot of work to do, to look at their outcomes through the entire product lifecycle and go through all of the content that is in this consultation. This will impact on the FCA's competition objective as the costs of reviewing consultations and implementing controls are non-linear and will fall most heavily on smaller firms who may then decide to exit the market.
5. Given the financial capability of the UK populace it will be more challenging for regulated firms to demonstrate they are delivering the customer's 'best interests'. For example, regulated firms may explain all of the risks, costs and expected performance of the product. However, certain consumers still may not understand percentages, for example and that would then leave the regulated firm on the proverbial 'hook'. It is clear the FCA is seeking to mitigate such circumstances through these proposals. We support the view that it is not sufficient simply to give customers the information eg, expected return 7%, costs 1% p.a. and risk of not performing 10%, as percentages. Regulated firms will need to make sure customers have understood the information presented to them. Therefore, if a regulated firm is dealing with vulnerable customers who do not understand percentages, then they should not use percentages to communicate. In the face of such challenges standardised product documentation would be difficult for regulated firms to draft. Some firms may then de-risk their book and exit vulnerable customer groups.
6. The FCA intends the regime to be proportionate but until we see the second consultation and until the FCA's Enforcement and Supervision plans are made clear, it will be difficult for firms to judge, ex ante, the number and frequency of checks they should implement. More importantly, it will take the first two or three FCA enforcement cases for the market to understand, with full clarity, the FCA's intent. In the face of this uncertainty some firms may exit the market, particularly where profits are low and the risk of being found non-compliant is high, those products which typically serve poorer customers. The FCA's new Duty could have the unintended consequence of reducing service provision to those who are most vulnerable.

IV – THE PRUDENTIAL AND BUSINESS MODEL IMPACT OF PROPOSALS

1. We agree and fully support the FCA's intent to address areas of unfair pricing. At the same time, we note and are aware that the FCA's stance on back-book pricing could have a material impact on the business models of many financial services firms. If all examples of 'loyalty taxes' are eliminated it would have a detrimental impact on regulated firm finances and whether they could continue to operate. Many firms, including some large banks which serve a great many UK customers well, could have their viability threatened. It is unclear if the FCA is aware of this or if it plans to undertake such an assessment of the relevant business models and consequent market impact. This is an important aspect of the proposals which strikes at the core of businesses and how they make money, but which could have a material impact on service provision and competition in UK financial services markets. Competition may be adversely affected to the detriment of UK consumers' interests.
2. We note that a number of firms' business models are highly dependent on back book pricing. Several large banks depend on paying lower rates on back-back deposits and earning income on SVR mortgages and that supports the NIM they are able to achieve. Both SVRs and back book savings rates are examples of a 'loyalty tax'. If eliminated in their entirety it will affect a great many firms, their viability and the plurality of UK financial services markets. The FCA's actions on general insurance pricing are expected to cost billions of pounds (£1.2bn). **If other financial services sectors are affected with similar losses of billions of pounds. This would be useful to know ahead of any policy decisions (See Actions I and J) as we and the FCA would not wish the see UK consumers left in a worse position.**
3. The FCA previously stated they were not a 'price regulator' but for general insurance they have now taken a stand against the 'loyalty tax'. We recognise the outcome the FCA is seeking to achieve, fair pricing for consumers, but if the FCA pushes too hard, firms may cease service and product provision in the UK.
4. Our concerns and recommendations are therefore two-fold.
   a) Firstly, it may be possible to build on the existing work of the UK's regulators. Both the FCA and PRA have undertaken work to assess the business models of the firms they regulate. Using this existing intellectual collateral, the FCA could make an assessment of the likely impact of the loyalty tax being eliminated for individual firms and on the consequent market structure and competition that results. After such an assessment, with fuller information of the possible impacts, the FCA would be in a better position to make a considered decision about loyalty taxes in the round.
   b) Secondly, we recognise that this is a difficult, balanced and nuanced decision. If firms withdraw from the market because of low profits, it could actually create gaps in what the industry provides. We think the FCA recognises this and has made such a finely balanced decision in the area of high-cost credit. The FCA effectively pursued some firms charging very high rates but, they were not so aggressive towards firms charging less. We welcome the FCA's practical approach, that albeit elevated rates are better than customers seeking credit from unregulated and unsavoury sources.
5. As above, we support the FCA's objectives and the goal of achieving better treatment of UK consumers; firms pursuing profits at the expense of the fair treatment of consumers is never a practice that should be repeated consistently across the industry. However, if a consequence is that too many firms exit the market then that could leave UK consumers in a worse position. Only the FCA (and the PRA) have the information to make this assessment and they could leverage their existing body of work to make such an evaluation quite quickly.

V – PRIVATE RIGHT OF ACTION

1. On the one hand, a private right of action (PROA) may act as a good deterrent, to stop bad market practices; if that 'stick' is there. However, we think the risk of unintended consequences needs further consideration.
2. If angry consumers take action, then it will be those specific cases that could determine much of the shape of UK consumer protection. This could foreseeably create at least two issues. One is that the socioeconomic background of the individuals that may choose to take PROAs may not be reflective of UK wider society so the UK's consumer protection laws may become skewed to particular products, services and customer issues which may or may not be representative of the UK populace.
3. The second issue and the most important one is that the FCA would then lose control to some extent, of where the 'red lines' are, and this would effectively be delegated to the judicial system. This shows due deference and respect for the role of the UK courts. However, definitions of what is 'fair' and what is 'reasonable' could be very different to what the FCA would like to achieve through its endeavours to raise the bar.
4. This is far from spurious supposition; this issue crystallised with the case of Plevin PPI. In that case the FCA had to respond to the court's rulings on commission payments and change its Rules and Guidance.
5. As above, and as we set out under Risk II, we agree with the sentiment of the FCA's proposal to raise the bar, but we feel the real life cases show this risks the FCA losing control of the conduct agenda in a way that may not deliver the best outcomes for UK consumers. This may follow through an increase in the scope of FSCS compensation claims leading to an increase in the levy over time, an impact on the Ombudsman service (FOS) through more speculative cases being taken against firms and the burden on UK courts more through the actions of Claims Management Companies and more litigation following firm collapse or misconduct.

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