

NFDA Consumer Duty Briefing

MAY 2022

Executive Summary

1. The new Consumer Duty is being introduced by the FCA. Final rules and guidance are due to be published in July 2022 and must be implemented by April 2023. The starting point is for everyone to understand what it is.
2. The new Consumer Duty is: -
 - made up of 3 parts (i) Consumer Principle; (ii) 3 cross cutting rules; and (iii) 4 outcomes.
 - it will be an additional Principle for Business. At the moment there are 11 Principles for Business. Once the new Consumer Duty is fully implemented there will be 12 Principles for Business.
 - the new 12th Principle for Business will be **“A firm must act to deliver good outcomes for retail customers”** (Consumer Duty).
 - not a new process, not a tick box exercise, not completing a new form or document.
 - requires a new approach, a new mind-set, a new way of doing business. A regulated firm must have and operate a customer centric business model. The focus will be on meeting the wants and needs of each and every customer, in particular those who are classed as vulnerable.
 - requires positive action: **“A firm must act to deliver good outcomes for retail customers.”**
3. The three cross cutting rules which support the consumer principle also confirm that positive action is needed. The 3 rules are: (i) take reasonable steps to avoid causing foreseeable harm to customers; (ii) take reasonable steps to enable customers to peruse their financial objectives; and (iii) act in good faith. Therefore, you cannot comply with the new Consumer Duty by doing nothing (an omission) or failing to act.
4. The 4 outcomes relate to: (i) Products and Services; (ii) Price and Value; (iii) Customer Understanding; and (iv) Customer Support.
5. The Consumer Duty is wide in scope and will apply to the sale of finance and insurance and potentially capture non-regulated products and services.

The new Consumer Duty is designed to raise the standard of consumer protection generally.

At this moment in time, the FCA believe that firms are not always consistently and sufficiently prioritising **good customer outcomes**. Too often consumers do not get the benefits or value from products and services and/or

they do not get the information or help that they need, when they need it. Being given **too much information** is seen by the FCA as being just as detrimental to a consumer as not being given enough.

Unlike TCF, firms will have to demonstrate **by evidence** that they are complying with the new Consumer Duty. The Consumer Duty is as much a **heart and mind** exercise as it is an operational matter. In other words, do not just say you are delivering good customer outcomes “show me” that you are.

What is the new Consumer Duty?

RULE: A firm must act to deliver good outcomes for retail clients

The new Consumer Duty states that “**a firm must act to deliver good outcomes for retail clients**”. What you will notice about the Consumer Duty is that there is a strong focus on taking action - positive action and behaviours are required. It is a new approach, a new mindset, a new way of achieving compliance through positive action, behaviours and outcomes. It is very much linked with the Senior Managers & Certification Regime and the Conduct Rules.

The Consumer Duty is made up of three distinct parts.

- (i) A new **Consumer Principle** which will be a new addition to the FCA’s Principles for Business.
- (ii) This consumer principle is supported by **3 cross-cutting rules**; and
- (iii) **Four outcomes** setting out more detailed expectations as to how regulated firms can meet the new Consumer Duty.

As you are aware there are currently 11 Principles for Business. The new Consumer Duty will be classed as the **12th Principle for Business** - “***A firm must deliver good outcomes for retail customers***”.

Cross Cutting Rules

The Consumer Duty will implement three key **RULES** that it expects regulated firms to apply on a cross-cutting basis across all the FCA Handbook rules and guidance. The FCA expects the following three cross cutting rules (or key behaviours) to develop and amplify the Consumer Principle which are:

- Take reasonable steps to avoid causing foreseeable harm to customers.
- Take reasonable steps to enable customers to peruse their financial objectives.
- Act in good faith.

Each of the cross-cutting rules apply **at all stages of the customer journey** and during the whole lifecycle of a product. In addition, each of the cross-cutting obligations requires firms to understand and take account of cognitive and behavioural biases and the impact of characteristics of vulnerability and/or lack of knowledge on

retail customers' needs and decisions. A firm will not be acting in good faith or reasonably where it seeks to exploit its interactions with retail customers and that exploitation is likely to lead to retail customer detriment.

Case Study (avoid foreseeable harm example): exploiting customer vulnerability

A Sales Executive is dealing with a customer who has severe dyslexia. Whilst the customer has agreed to take out Tyre Insurance, the Sales Executive takes advantage of the customer's vulnerability and lack of ability to read and absorb written information by including Cosmetic Repair, Alloy Wheel and paint protection into the deal without the customer's knowledge or consent. This **type of behaviour** would be a breach of the requirement to avoid foreseeable harm. Whilst you would not see the harm by inspecting the deal file, the harm still does exist. In many cases like this one, friends or relatives tend to inspect the sale documentation some months after the transaction has been completed and then raise a complaint that the customer has been misled.

The harm could have been avoided by communicating properly with the customer, explaining the products available to him and ensuring that he wanted these extra products before including them in the sale. This type of conduct raises a whole host of other regulatory breaches in addition to a breach of the new Consumer Duty such as an unfair sales practice and breach of Conduct Rules.

Case study (reasonable steps that consumer achieves financial objectives): choosing the product based on suitability not on the ancillary benefits

A dealership has financial arrangements with three lenders (A, B and C). Lenders A, B and C all offer PCP but only lender C offers Hire Purchase. Lender A has a low rate offer available at the moment, but the offer is subject to a minimum deposit contribution of £5,000. Lender B is offering its standard rate on PCP but will offer a 1-year Service Plan free of charge with this product.

A customer visits the showroom and makes it clear that he does not want PCP. He only wants Hire Purchase. The dealership therefore is only able to offer him finance with Lender C. The fact that the low rate offer and the free service plan is available through the purchase of another financial product with another lender does not mean that the salesperson must actively try to persuade the customer to take out a product that he does not want. Explaining the different options is acceptable; trying to redirect a customer down a different path based on finance commission or other matters not relating to the customer's wants and needs is not. It may be worth trying to explore the customer's reason for wanting a particular financial product. Offers should not be the main driver of the most appropriate financial product selection.

The Consumer Duty requires the dealership to enable the customer to pursue his financial objectives. The customer's financial objective here is to take out Hire Purchase to fund the purchase of a vehicle. Providing the customer understands that the offers are only available with other lenders (and with other financial products), and he is given sufficient information to make a fully informed financial decision in his own best interests, then the Consumer Duty has been complied with. If the decision made by the customer turns out to be inappropriate, then the Consumer Duty has still been complied with by the dealership.

The Four Outcomes

The 4 outcomes cover the following:

1. **Products and services** (*i.e., product governance, is the product or service fit for purpose, meets the target audience etc.*)
2. **Price and value** (*i.e., does the price deliver on fair value outcome and can it be **evidenced** that it delivers on the quality element also*)
3. **Customer understanding** (*i.e., does the customer know what they are buying, and can we demonstrate they were making informed decisions*)
4. **Customer support** (*i.e., does customer receive sufficient support at all stages of the journey, are your complaint handling processes sufficient?*)

It will be essential that dealers can evidence that they are delivering the 4 outcomes to customers.

Note:

Nowhere in the Consultation Paper, the rules or the guidance, does it reference Commission Disclosure (directly or indirectly).

Outcomes desired from the Joint NFDA / FLA meeting?

- FLA members to work with NFDA members to create an agreed framework that delivers on all four consumer outcomes for all parties in the distribution chain
- Consistency will be key, as will collaboration to achieve good customer outcomes at all stages of the customer journey
- Work together and share best practice (what progress is being made on product governance, documentation, etc.)