CP 21/36: a new consumer duty

Response from Shoosmiths

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We welcome the opportunity to respond to the Financial Conduct Authority's consultation paper CP21/36: A new Consumer Duty.

Shoosmiths LLP is an FCA authorised firm, but our responses in this paper represent our thoughts, as legal and regulatory advisors, on how the proposals would affect our clients and the broader financial services market. We are not responding in terms of how the proposals might affect Shoosmiths LLP as an FCA authorised firm.

We do not comment on those matters where the FCA has considered responses to the first consultation paper and as a result it seems reasonably clear that the FCA's position will remain as stated.

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?

In paragraph 3.32 the FCA proposes that the Consumer Duty would apply to unregulated activities which are "ancillary to" regulated activity, meaning "activities carried on in connection with a regulated activity or held out as being for the purposes of a regulated activity". Please can the FCA clarify this? For example, it would appear to cover:

- introducers of customers for savings accounts or payment services – in such cases, the introducing activity is not regulated
- technical service providers who support the provision of IT and communications solutions, for example in relation to payment services activities

As the providers of such services fall outside the regulatory perimeter, the regulated firm engaging the services of the unregulated provider would have to ensure the service agreements imposed contractual obligations on the provider so as to ensure the regulated firm's compliance with the Consumer Duty (this is the effect of paragraph 3.35). How will this work in practice? Our concerns are:

- firms will have to conduct a gap analysis of the obligations set out in service providers' standard terms against what they believe is required (based on FCA guidance, which might not be comprehensive), and seek to negotiate changes
- this will affect existing service agreements
- service providers may not agree to such changes, especially if different firms (again based on FCA guidance, which may not be comprehensive) take different interpretations
- if service providers do not agree to such changes, will firms be expected to (a) not enter into a contract with them or (b) if the contract already exists, terminate it? For example, the draft non-Handbook guidance (paragraph 2.15) says that firms must consider if outsourcing customer servicing could have a negative impact for customers, which appears to align with the EBA Guidelines on Outsourcing listing this as a potential event which should allow termination of the relationship
- termination may not be possible without cost, or without risking breach. The notice period for termination of existing arrangements may be significant
- during any exit period the firm will still be relying on a service provider whose services do not allow the firm to meet Consumer Duty standards. How does the FCA propose that firms handle this, given that there may be no practical way for the firm to mitigate the risks while arranging migration?

Paragraph 3.25 lists agency banking as an example of where it would be inappropriate to make a wholesale firm subject to the Consumer Duty. However, at least some agency banks apply the "corporate opt-out" under the Payment Services Regulations, meaning that the protections afforded to consumers, micro-enterprises and small charities are not extended to the banks or building societies for whom the agency bank provides clearing services. Notwithstanding this, those banks or building societies will have to extend full protections to such customer types, and the Consumer Duty will apply to them. Does this leave those banks and building societies at a disadvantage, and potentially mean that they may have to change agency bank? Should agency banks be encouraged (at the very least) not to apply the corporate opt-out in such circumstances?

Paragraph 3.26 uses the term "material influence". This is the only time that phrase is used in the consultation paper and it is not defined. If one is able to interpret this phrase using the precedent of "significant influence" or "control" (both of which are defined in the Glossary to the Handbook), it would appear that in order for a person to be within scope of paragraph 3.26, it would need to "guide the hand of" the person primarily in scope of the Consumer Duty. We are concerned also that design of and communications relating to retail products and services are separate and distinct from the operation and distribution of retail products and services. Those activities are covered by existing, long-standing rules and regulations, such as PRIIPS and it's regulatory technical standards. Without additional clarity and guidance, the Consumer Duty is at risk of all wholesale market participants understanding that the Consumer Duty does not apply to them or does not change their existing obligations.

What is the expectation on outsourcing / third party service provider / cloud agreements? Any reference to the supplier having an obligation in the agreement to do with 'Consumer Duty' will be resisted by them, so what should this translate into as contractual terms? Are suppliers expected to (for example) have an obligation to make the firms aware that something is / may not meet the Consumer Duty obligation?

Is there enough time proposed before the rules go live to ensure the responsibilities and information in the chain can be managed correctly?

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?

Please see the comments above under Question 2, in particular the question around whether firms will be expected to terminate existing arrangements.

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

The cost reviewing, redesigning, amending products and documentation is very likely to cause some less profitable products to be removed from the market, hence reducing choice. Please see the comments above under Question 2, in particular the question around whether firms will be expected to terminate existing arrangements. Firms may be able to offer certain products at a low margin because they are typically sold in conjunction with more profitable products but if the latter are considered in isolation, they may not meet the FCA's price and value outcomes.

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

Guidance will be vital here to make sure we understand the obligations for firms acting at a distance etc. and whether this is regarded as "execution only" or whether firms are expected to offer help/advice routes in a journey.

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

The testing of promotions and communications has the potential to slow down and add expense to the process, but there is merit in the requirements. The FCAs financial promotion rules are the source of many of the confusing requirements that customers do not understand e.g. representative examples. The financial promotion rules should enable firms to communicate in a clearer, simpler manner and be proportionate to the media type and place in the customer journey.

We note the FCA's view at paragraph 9.12 that firms should follow existing legislative and regulatory disclosure requirements, but the consumer understanding outcome will also require firms to think more widely about the purpose of communications. As the FCA notes, consumer credit documentation is heavily prescribed. Asking lenders to add an extra layer of explanation to the existing requirements is unhelpful and creates a risk of consumers ignoring key notices and statements due to information overload. In our experience, firms are keen to use innovation to make consumer credit disclosures in a more customer friendly manner, however such firms are still required to provide the core consumer credit documentation. This adds an extra layer to the process rather than simplifying it for a customer. It is critical that the FCA prioritises its work with the Treasury to modernise consumer credit legislation to allow consumer credit to benefit from a simpler, more streamlined regulatory framework.

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

In CP21/13 the specific issue on which the FCA sought views was the introduction of a PROA for breach of the Principles. The FCA was considering whether the present position that a breach of Principle (rather than any underlying rule) is non-actionable should also apply in respect of the proposed Consumer Principle. Our previous response was based on that being the issue on which the FCA was consulting and we anticipate many responded on that basis as well.

In CP21/36, however, the FCA states that it does not intend to introduce a PROA at this time for breaching any part of the Consumer Duty. This deviates from the usual position where breach of a rule is actionable. We note that the FCA intends to give effect to this decision by "switching-off" the rights that would otherwise exists under section 138D (which would also mean that rights under the FSCS and section 404 will not be available).

The rationale is that the existing framework is likely to be a more appropriate route for all consumers seeking redress. The FCA acknowledges that this will exclude claims which exceed the FOS compensation limits where a consumer would otherwise have the right to proceed with Court If the rights under section 138D were not disapplied.

We acknowledge that FCA's underlying rationale is to allow individuals to pursue claims at no additional cost and without representation. We also agree that firm's will be expected to resolve complaints fairly and effectively and our experience is that most responsible firm's aim to do so.

However, we have the following observations which we would invite the FCA to consider:

- An individual with a consumer duty-based claim at a value which exceeds the FOS jurisdictional limit would not have a remedy under the scheme (or a partial one only) whereas an individual with an identical but lower value claim would have a remedy.
- Account needs to be taken of the extension of the Fixed Recoverable Costs regime when considering whether Court proceedings are not appropriate because of the likely cost that would be incurred in pursuing a claim. The FRC is intended to ensure that the costs of legal proceedings are proportionate to the value of the claim.
- The FCA's approach tends to assume that a consumer's only rights are either to refer matters to the FOS or to proceed by way of section 138D (the statutory cause of action). However, a consumer may also have claims for breach of contract and/or negligence under common law where the underlying facts may also amount to breaches of the proposed rules There may also be claims based around dishonesty (for example fraudulent misrepresentation) as a result of matters which would also amount to a breach of proposed rule 2A.2.1.
- Furthermore, situations are likely to arise where a breach of proposed Consumer Duty rules is also a breach of existing rules under the Handbook and where the statutory cause of action remains. For example, where a retail consumer is given unsuitable investment advice which breaches both the Consumer Duty rules and say, for instance, the client's best interests rule under COBS. Such a consumer could bring a civil claim for breach of COBS but not breach of the Consumer Duty. The Court would be assessing the claim against the lower COBS standard (because it would be prevented from considering a claim based on breach of the Consumer Duty rule). In such circumstances, conceptually at least, the Court could reject a claim on the basis that there is no breach of the COBS rules, even though, had the Consumer Duty rules been actionable, the claim would have been upheld.
- The FCA's approach proceeds on the basis that the FOS will have the time, resource and expertise to deal with all breach of Consumer Duty claims (which will range in complexity and value). We do not consider that assumption will be universally accepted as being the case.
- There are circumstances where the FOS accepts that it is not appropriate for it to exercise its jurisdiction. CMCs, however, are likely to always frame a claim as engaging the Consumer Duty on the basis that, because only the FOS can consider such a claim, it will be possible to argue that refusing jurisdiction would leave a consumer without a remedy because the claim cannot be pursued in any other way. As such, the FCA's approach is likely to result in more complaints to the FOS being initiated by CMCs.

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

There is a significant amount of work to be undertaken before April 2023 and a a phased approach or transitional period may help. As noted above, firm's may need to exit existing contractual arrangements but the termination provisions may be lengthy and may extend beyond that date.

For some firm's the new requirements will involve a wholesale review of a large number of products and services.

We appreciate that a deadline must be given for implementation, but we also believe that the FCA will in due course have to exercise understanding when it finds that firms are struggling to meet that deadline, through no lack of action on their part.

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

In paragraph 1.29, the FCA says that implementation of the Consumer Duty will be iterative, with the FCA learning as it goes from firms' implementation and reviews of products and services. This of course makes sense in principle, but we have a question on how the lessons learned by the FCA will feed into updated non-Handbook guidance, and how this will be managed. There is the potential for changes to affect a firms' policies, processes, training, product design, customer-facing material and contractual arrangements with third party service providers.

For this reason, we support the principle of engagement with stakeholders (mentioned in paragraph 1.30) when the FCA proposes to issue further guidance which could reasonably be expected to have an impact on firms. This will result in discussions that are bilateral, informed and balanced and where, appropriate, will ensure a cost-benefit analysis is created. This will also help ensure that the timescales for reasonable adjustments to reflect the updated guidance are understood.

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