

A step forward for consumer protection but proof is in the enforcement

Destined for greatness or unrealised potential? **John Verwey** and **Sulaiman Malik** provide an overview of the FCA's Consumer Duty and its implications for the UK financial system.

In July 2022, the Financial Conduct Authority published a policy statement (PS22/9) [1] and final guidance (FG22/5) [2] for its new 'Consumer Duty'. In the FCA's own words, the Consumer Duty *"sets higher and clearer standards of consumer protection across financial services and requires firms to put their customers' needs first"*.

The Consumer Duty is directly applicable to FCA-authorized firms that provide products/services to retail customers. Other entities in the distribution chain may also be indirectly subject to the requirements, to the extent they have *"material influence"* over consumer outcomes. Such firms will need to *"conduct their business to a standard which ensures an appropriate level of protection for retail customers"*.



The main rules under the Consumer Duty came into force for *"open"* products/services – new and existing products or services that are open to sale or renewal – on 31 July 2023. From 31 July 2024, the Consumer Duty will also apply to *"closed"* products/services – that is, existing contracts with retail customers which were entered into before 31 July 2023.

The current economic environment and the importance of consumer protection

In many ways, it should come as no surprise that the FCA has chosen to focus on consumer protection. Unexpected large-scale events such as the Covid-19 pandemic and the war in Ukraine have disrupted global supply chains in unprecedented ways. According to a House of Commons research briefing published in July 2023, the annual rate of inflation in the United Kingdom reached 11.1 per cent in October 2022 – a 41-year high, before easing in subsequent months. Between June 2021 to June 2023, food prices rose by 28.8 per cent. It previously took over 13 years, from March 2008 to June 2021, for average food prices to rise by the same amount. [3]

The current economic environment has placed extreme financial pressure on retail customers, as household budgets are continually needing to stretch further. Many are finding themselves in a position of vulnerability not seen since the Global Financial Crisis, emphasising the importance of robust rules to protect consumers.

Beyond the macroeconomic factors, the rapid development of technology has meant that retail investors are more accessible than ever and riskier products utilising nascent technology are readily available to them. The FCA has recognised this as well – in June 2023, the FCA published new, tougher financial promotion rules for cryptoassets, which include requirements such as risk warnings and *"cooling off"* periods to allow consumers to make a more informed choice. [4]

Even in a perfect economic environment, outside of maintaining financial stability, a regulator's key responsibility is to protect consumers. Such protection is vital to the overall health of the financial system, as without it consumers in the UK may become hesitant to engage with financial services if they are victims of frequent financial mis-selling or misconduct.

Financial stability and the Consumer Duty are also directly tied. Mis-selling financial products, for example, oftentimes results in consumers agreeing to obligations they are unable to meet, eg if a consumer is mis-sold a mortgage, it will come as no surprise when they default. No-one needs to be reminded of the knock-on effects this particular example could have on the financial system overall. In other words, widespread failures to meet the Consumer Duty could eventually result in systemic risk.

For all these reasons, there has never been a more apt time to bring in regulatory measures with the goal of further protecting consumers, and for this alone the introduction of the Consumer Duty is welcome.

Consumer Duty and principles-based regulation

The FCA has always applied a principles-based approach to aspects of its regulation and the Consumer Duty is a further continuation of this. A key element is the introduction of a new Principle in its Principles for Businesses *"to deliver good outcomes for retail customers"*. [5] This overarching Principle is underpinned by:

- *"cross-cutting rules"* to (i) act in good faith towards retail customers, (ii) avoid causing foreseeable harm to retail customers, and (iii) enable and support retail customers to pursue their financial objectives; and

- “outcomes” relating to (i) products and services, (ii) price and fair value, (iii) consumer understanding and (iv) consumer support.

However, principles-based regulation and the flexibility that comes with it is a double-edged sword: on the positive side it gives firms the discretion to implement the Consumer Duty in a way that is most appropriate for their business model; but on the negative side this can lead to uncertainty among firms as to how to comply with the new requirements and this may result in a failure to achieve the outcomes which the Consumer Duty is seeking to achieve.

How to address the regulatory uncertainty and ensure compliance

The FCA has taken a good first step to mitigate issues of uncertainty – publishing its detailed final guidance alongside the Consumer Duty policy statement. Still, the FCA must maintain a continuous dialogue with the market and, as further queries arise, it must be prepared to deploy detailed guidance in short order.

The guidance should not be limited to firms – the consumers themselves also need to understand the obligations owed to them. Further financial education is important and the FCA should continue to build out accessible resources for the public. Consumers will not be able to reap the full benefits of the Consumer Duty (or report breaches) if they do not understand their rights.

The FCA has previously had successful campaigns to inform the general public – who can forget a robotic Arnold Schwarzenegger reminding us of the deadline for PPI claims? [6] The guidance needs to be responsive to emerging issues but, more importantly, it must be published in a way that actually reaches the public. The FCA currently has a helpful webpage for consumers, cutting through jargon and publishing warning notices. [7] The only issue is that the general public does not read the FCA website.

If the guidance is not enough for firms to implement the Consumer Duty correctly, the FCA will need to carry out enforcement against firms that fail in their obligations under the Consumer Duty and for the penalties imposed to be widely publicised. Without enforcement, the FCA’s grand statements about consumer protection start to ring very hollow. Striking the right balance between punitive measures and encouraging compliance will be essential to maintaining consumer trust and confidence in the financial system.

The FCA will also need to monitor issues of financial inclusion. Using the discretion afforded to them, firms may be deterred from providing accessible products to particularly vulnerable groups if it becomes too onerous to do so. The Consumer Duty seeks to protect all consumers, but in doing so the FCA should ensure certain consumers are not excluded from access to particular financial products entirely.

UK as a leading light in regulation and financial product innovation

The Consumer Duty is somewhat unique to the UK, placing additional obligations and burdens on UK firms that businesses in other countries will not need to contend with. Regulatory divergence always results in the same question arising – how will this impact the UK and the City of London as a global financial hub?

Effective guidance could mitigate concerns about international competitiveness. Firms may actually be further incentivised to operate in the UK if their obligations to consumers are clear. After all, English law is one of the country’s best exports – not because it is a permissive legal system, but due to the legal certainty it provides.

Notwithstanding the musical chairs at 10 Downing Street, one message has remained clear from the Government – the UK’s regulatory regime can be better compared to when it was a member of the European Union. So far, this has largely amounted to political posturing. The Edinburgh Reforms, for example, seek to cut EU ‘red tape’ and allow the UK to become a global leader within financial services, but it is too early to determine how effective this will actually be.

Proper implementation of the Consumer Duty will require the FCA to walk a tightrope of sorts – balancing flexibility, guidance and enforcement. If the FCA gets this right, however, the Government’s messaging starts to become more credible – the UK could become a global leader in consumer protection but also in the production and innovation of financial products appropriate for such consumers.

Notes

[1] Finalised guidance, ‘Final non-Handbook Guidance for firms on the Consumer Duty’ (FG22/5), published on 27 July 2022: www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf.

[2] Policy statement, ‘A new Consumer Duty’ (PS22/9), published on 27 July 2022: www.fca.org.uk/publication/policy/ps22-9.pdf.

[3] Research briefing, ‘Rising cost of living in the UK’, published on 21 July 2023: <https://researchbriefings.files.parliament.uk/documents/CBP-9428/CBP-9428.pdf>.

[4] Policy statement, 'Financial promotion rules for cryptoassets' (PS23/6), published on 8 June 2023: www.fca.org.uk/publication/policy/ps23-6.pdf.

[5] FCA Handbook, 'PRIN 2.1 The Principles', published on 31 July 2023: www.handbook.fca.org.uk/handbook/PRIN/2/1.html.

[6] Press release, 'FCA starts countdown to PPI complaints deadline with advertising campaign featuring Arnold Schwarzenegger', published on 29 August 2017: www.fca.org.uk/news/press-releases/fca-starts-countdown-ppi-complaints-deadline-advertising-campaign.

[7] FCA webpage, 'Consumers': www.fca.org.uk/consumers.

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