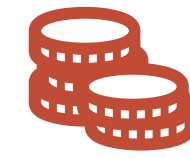


# The new Consumer Duty and the implications for retail firms

March 2022







# Introduction

At the end of 2021, the FCA published [CP21/36](#), a further consultation on the Consumer Duty which includes feedback on its previous consultation [CP 21/13](#) together with new draft regulations for applicable firms. For background on [CP 21/13](#) and the introduction of the new Consumer Duty please see our briefing [here](#).

In this briefing we consider the FCA's approach to the Consumer Duty, and what the proposed new rules will mean for firms. For in-scope firms, there is much to consider before the intended implementation date of 30 April 2023.

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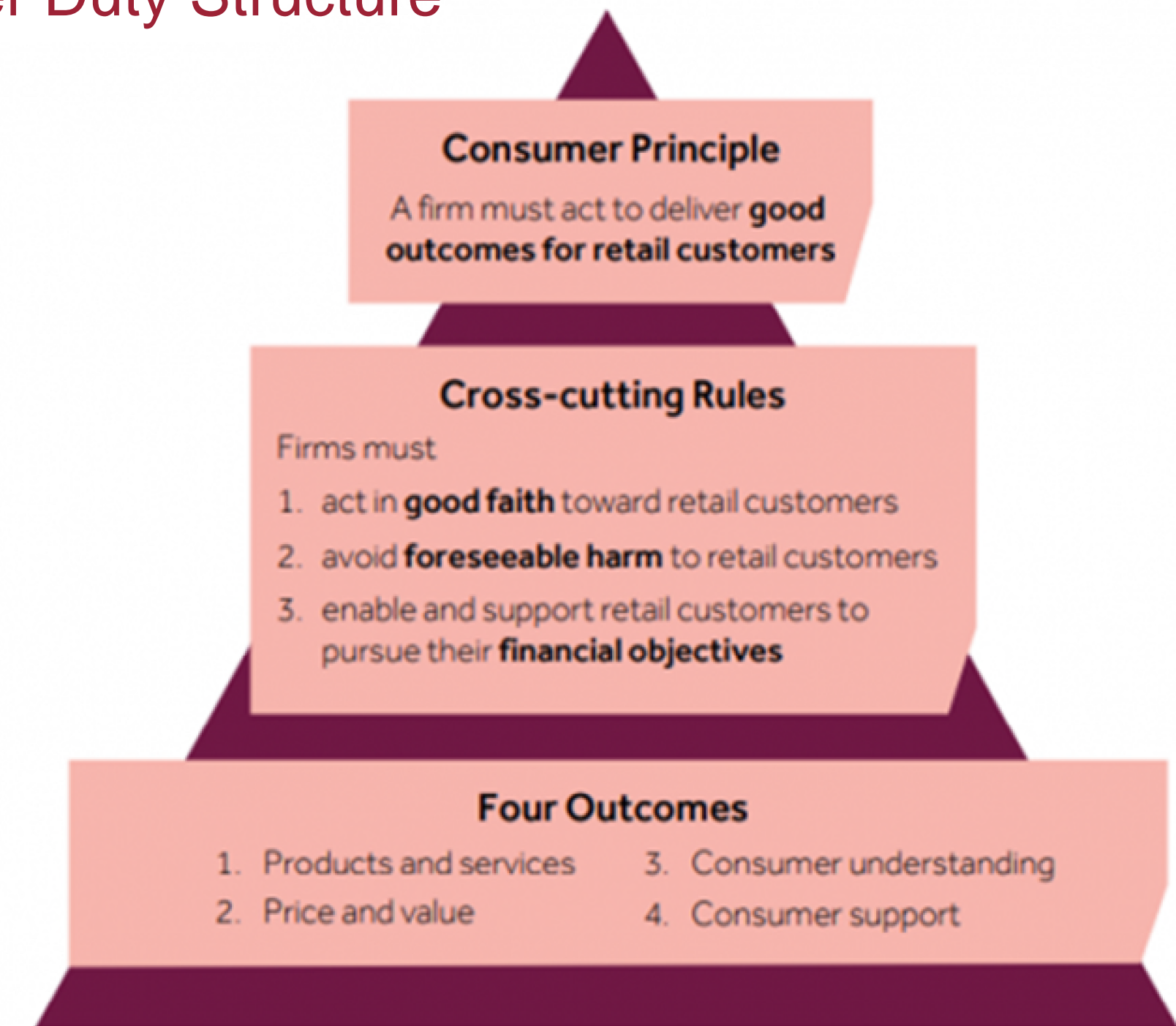


# What is the Consumer Duty?

The FCA is introducing a new Consumer Duty to drive up standards in retail markets and reduce harms that consumers may face in the financial sector. The FCA has designed the Consumer Duty as an outcomes-based set of principles, rules and guidance, which all firms providing services to retail customers will be required to follow. The Consumer Duty will consist of three main elements as set out below.

While the tripartite structure remains from the previous consultation, the FCA has taken on board elements of the feedback it has received and has confirmed the wording for the Consumer Principle and developed its approach to the cross-cutting rules and four outcomes.

## Consumer Duty Structure



\* Diagram from FCA CP21/36





# The Consumer Principle

The FCA has adopted the following wording for the Consumer Principle - **a firm must act to deliver good outcomes for retail customers**. The FCA is clear that this wording represents an extended regulatory duty when compared with firms' existing duties under Principle 6 which requires firms to pay due regard to the interests of its customers and treat them fairly.

The FCA believes that the proposed wording reflects its expectation that firms should “consistently focus on consumer outcomes and will put consumers in a position where they can act and make decisions in their interests.”

The Consumer Duty will be underpinned by a concept of “reasonableness”. The FCA is clear that it's focus is on firms acting **reasonably** to deliver good outcomes for retail consumers. The new Consumer Duty, including the Consumer Principle, does **not**:

- mean that consumers can or will be protected from all harm;
- impose an open-ended duty to protect consumers from all potential harms; or
- remove the principle of consumer responsibility.

## How the Consumer Principle interacts with existing Principles

In CP 21/13 the FCA asked for feedback as to whether Principle 6 (**a firm must pay due regard to the interests of its customers and treat them fairly**) and Principle 7 (**a firm must pay due regard to the information needs of its customers, and to communicate to them in a way that is fair, clear and not misleading**) should be disapplied in situations where the new Consumer Principle applies. Following the feedback it received, the FCA has decided to disapply Principles 6 and 7 where the new Consumer Principle 12 applies as it imposes a higher standard of conduct. Principles 6 and 7 are retained for business outside the scope of the Consumer Principle, such as certain SME clients.

The FCA will retain the Handbook and non-Handbook guidance relating to Principles 6 and 7 for retail firms, although firms should tread with caution when relying on such guidance to meet their new Consumer Duty obligations as this extends the FCA's expectations of firms.

The new Consumer Principle will be Principle 12 within the PRIN sourcebook and will be supported by PRIN 2A which will set out rules and guidance associated by the new Consumer Duty.



# Cross cutting rules and guidance

To further clarify and amplify the standards of conduct it expects under the Consumer Principle, the FCA is introducing cross cutting rules and guidance. Three key behaviours will be expected from firms which will apply on a “cross-cutting” basis across the whole of the existing handbook rules and guidance.

The three key behaviours are explained below.

Cross cutting behaviours	
Act in good faith	This is a standard of conduct characterised by honesty, fair and open dealing and consistency with the reasonable expectations of consumers. The FCA believes that this requirement acknowledges the inherent imbalance (eg, knowledge, bargaining position etc.) in the relationship between clients and financial services firms. While consumers have a role to play if they are to achieve good outcomes, the FCA’s view is that consumers can only reasonably be expected to take responsibility for their choices and decisions if firms act openly and with honesty.
Avoid causing foreseeable harm to customers	This requires firms not to cause harm to customers through their conduct, products or services. It also requires firms to take proactive steps to avoid harm (where it is within the firm's control to do so). Firms should not seek to exploit customers' vulnerabilities, behavioural biases or lack of knowledge.
Enable and support customers to pursue their financial objectives	This means that firms should take responsibility for establishing an environment in which consumers can act in their own interests. The FCA has identified that harms may arise when firms do not sufficiently recognise and take account of consumers' behavioural biases and the impact that characteristics of vulnerability can have on consumers' needs. Firms should take reasonable steps to understand these factors and use their knowledge of how consumers behave to enable and support them to make good decisions.



# The “Four Outcomes”

To further support the Consumer Duty and to build on the Consumer Principle and cross cutting rules the FCA is proposing a new suite of rules and guidance which it has termed “The Four Outcomes”. The FCA intends these outcomes to represent the key elements of the firm-consumer relationship: including how firms design, sell and service products and services, and the key contact points along the customer journey. The Four Outcomes have been reviewed following feedback on CP 21/13 and are now grouped in the following areas.

## 1. Products and services outcome

Products and services should be specifically designed to meet the needs of consumers and sold to those whose needs they meet. The FCA proposes to set different requirements depending on a firm’s role in the distribution chain, with obligations for both manufacturers and distributors. The requirements on both manufacturers and distributors are similar to MiFID 2 derived product governance rules in PROD, and the FCA has indicated that, for firms currently subject to PROD, compliance with PROD will tend to establish compliance with this outcome.

The definition of both “manufacturers” and “distributors” is very broad; all firms which “create, develop, design, issue, operate or underwrite a product or service” fall within the scope of the manufacturer definition. Similarly, all firms which “offer, sell, recommend, advise on, propose or provide a product or service” are considered distributors by the FCA. A summary of the key obligations on both manufacturers and distributors is set out below.

Firms should bear in mind that they may be both a “manufacturer” and a “distributor” in relation to the financial services that they develop and market.

Obligation	Manufacturer	Distributor
Develop an approval process for products or services.	x	
Develop distribution arrangements for each product or service distributed.		x
Identify a target market of consumers for whose needs, characteristics and objectives the product or service is compatible	x	
Obtain information from the manufacturer to understand the product or service, its target market and its intended distribution strategy.		x
Consider if there are any consumers with characteristics of vulnerability in the target market and take account of any additional or different needs of those consumers.	x	
Test the product or service and ensure it is designed to meet the needs, characteristics and objectives of the target market.	x	
Select distribution channels that are appropriate for the target market and provide adequate information to distributors to enable them to understand the product or service and the target market.	x	
Regularly review the product or service and its distribution and take appropriate action to mitigate the situation if they identify circumstances that may adversely affect their customers.	x	X- obligation limited to distribution arrangements

## 2. Price and value outcome

The FCA, while acknowledging that customers have the ultimate responsibility for choosing whether to buy a product or service, is of the view that consumers should be able to rely on the firm taking steps to ensure that any product or service it offers represents fair value. Again, the FCA has set out considerations for manufacturers and distributors to take into account when considering whether the price for the product or service is a fair one.

Manufacturer Assessing fair value must include consideration of:	Distributor Must not distribute products or services unless:
The nature of the product or service, including the benefits that will be provided or that consumers may reasonably expect, and their quality.	It is satisfied that their distribution arrangements are consistent with the product or service providing fair value.
Any limitations that are part of the product / service.	It obtains information from the manufacturer to understand the intended value of the product or service and consider the impact that distribution arrangements, including remuneration, can have on value.
Any characteristics of vulnerability in the target market for the product or service.	

## 3. Consumer understanding outcome

The FCA believes that consumers can only be expected to take responsibility for their choices when a firm's communications enable them to understand their products and services so that consumers can make informed choices. While firms already have an obligation to consumers under Principle 7 (**A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading**), the Consumer Duty goes further as it requires firms to focus more on consumer outcomes and their understanding throughout the customer journey.

Importantly, firms should ensure that their terms and conditions (as a key communication and contract between firms and consumers) are clear, fair and easily understood by consumers.

Further, in order to meet this obligation, the FCA highlights a number of actions that firms should consider as part of meeting this outcome and a summary of key actions is set out below.

Consideration	Action
Tailoring messages	When designing a product, firms need to identify a target market, and when communicating with consumers firms should ensure that messages are tailored to the appropriate target market. For example, the target market for complex investments will have different information needs to the target market for a straightforward savings product. For customers in vulnerable circumstances, firms should take particular care and follow the FCA's <a href="#">guidance</a> .
Timely basis	Both products/services features (e.g., introductory rates come to an end) and consumer circumstances (e.g., retirement) can vary over time. Firms should be aware of this and communicate appropriately with consumers, for example prompting consumers to consider whether products still meet their needs. This is particularly relevant to products / services which are subject to longer term agreements.
Channels of communication	Whichever channel of communication is used, the communication should be effective. Digital communication should be compatible with a range of devices, including smartphones, laptops and tablets.
Testing and monitoring communications	Firms should ensure that their communications are understood not only by those that design them, but by their consumers. In order to test their communications firms could use various methods including engaging specialist firms, carrying out customer surveys or running focus group sessions.



The FCA again stresses that firms are expected to meet this outcome in a proportionate and reasonable manner. The outcome rules **do not** require firms to:

- tailor every message to every consumer;
- communicate via a particular channel;
- test all communications; and
- verify that all individual consumers have understood the communication.

#### 4. Consumer support outcome

The FCA expects firms to provide consumers with the support to allow them to realise the benefits of products and services. The FCA believes that this support will ensure that consumers can pursue their own financial objectives and can act in their own interests.

The overarching requirements of the customer support outcome are that firms:

- consider the support their customers need and make sure their customer service meets those needs;
- support their customers in a way that takes their needs into account, such as designing processes without unreasonable barriers that prevent consumers realising the benefits of the product or service, or acting in their own interests;
- monitor the quality of the support they are offering, looking for evidence that may indicate areas where they fall short of the outcome, and act promptly to address these; and
- ensure they do not disadvantage particular groups of customers, including those with characteristics of vulnerability.

#### Which firms will the Consumer Duty apply to?

In CP21/13, the FCA proposed that the Consumer Duty should apply all clients other than professional clients (such as large corporate entities and government bodies) and eligible counterparties (such as financial institutions). However, feedback to the FCA pointed out that this wide definition would be difficult to implement and could lead to anomalies, especially where larger and / or more sophisticated SMEs were concerned. In CP21/36 the FCA acknowledges this feedback and agrees that such a broad definition could lead to confusion regarding the scope of protection for a number of SMEs.

As a result of the feedback the FCA proposes to align the scope of the Consumer Duty with the existing scope of its sectoral sourcebooks. For example, for mortgages, the Consumer Duty would follow the position in the Mortgage Conduct of Business Sourcebook (MCOB). Further detail is set out in draft rules which are included at Appendix 1 to CP21/36.

A summary of other key aspects of the scope of the Consumer Duty are set out on the next page.



Key aspects of the scope of the Consumer Duty	Summary
High Net Worth (HNW) individuals	The Consumer Duty will apply all business with retail clients, including HNW business. The Consumer Duty will not apply where such clients are classified as professional clients, including when classified as elective professional clients. However, firms will need to consider the Consumer Duty when determining a client's status, including when opting up an elective professional client.
Unregulated Activities	While in general the FCA has noted that the Consumer Duty will not apply to unregulated activities, it is proposing that the Consumer Duty apply to unregulated activities which are ancillary to regulated activities being carried out by the firm.
Principles 6 and 7	Will continue to apply to firms dealing with wholesale or retail customers outside the scope of the Consumer Duty.
Jurisdiction	Only firms conducting regulated activities in the UK are within the FCA's remit. However, the FCA proposes to require UK distributors of non-UK products and services to take all reasonable steps to comply with the products and services outcome.
Prospective customers	The FCA has also confirmed that the Consumer Duty should apply to prospective customers for example, financial promotions are often targeted at potential customers, and firms should consider the needs, characteristics and objectives of a target market of customers when designing products or services.
Vulnerable customers	The FCA expects all firms to consider outcomes for vulnerable customers when implementing the Consumer Duty. It also notes that its recent <a href="#">guidance</a> for vulnerable customers still applies





# Monitoring and Governance

A key element of the new Consumer Duty is that firms monitor and review the implementation of the new Principle, cross cutting rules and outcomes to ensure that consumers obtain the benefits and avoid the harms that the FCA has identified and designed the Consumer Duty to deal with.

Therefore, firms need to:

- monitor and regularly review the outcomes their customers are experiencing to ensure that the products and services that they provide are delivering outcomes consistent with the Consumer Duty;
- identify where customers are not getting good outcomes and understand why;
- have processes in place to adapt and change products/services or policies/practices to address any risks or issues identified and stop it occurring again in the future.

In order to meet these obligations, the firm's governing body must at least annually:

- review and approve the firm's report on the outcomes being received by retail customers;
- confirm that it is satisfied that the firm is complying with its obligations under Principle 12 and PRIN 2A; and
- assess whether the firm's future business strategy is consistent with its obligations under Principle 12 and PRIN 2A.

The data and information that firms will need to collect and review in order to be able to meet these governance obligations will vary depending on the type of firm and its consumer base, but the FCA suggests that it could include complaints data, file reviews and training and competence records.

It is also worth noting that FCA will monitor how the Consumer Duty is embedded in the firm's business and that it expects the Consumer Duty to receive the same attention within a firm as financial performance or risk management.

Every senior manager in a firm must take responsibility for the role they can play in ensuring the firm complies with the Consumer Duty and the FCA intends to amend the conduct rules in the Code of Conduct sourcebook (COCON) as set out below.



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## Will the Private Right of Action be extended?

For many of the FCA's rules, individuals can bring a private action where a firm's breach of a rule causes them loss. This is known as the Private Right of Action. However, this does not currently apply to the FCA Principles for Businesses. As part of CP21/13 the FCA asked whether the Private Right of Action should be extended to all the Principles, including the new Consumer Principle.

Following feedback, the FCA has decided not to extend the Private Right of Action at this time, although it reserves the possibility of introducing such a right at a later date, depending on firms' compliance with the new Consumer Duty.



## What does the new Consumer Duty mean for firms and individuals?

Whilst CP21/36 re-enforces the significant shift in regulatory tone, the FCA previously adopted in CP21/13, the FCA has also developed how it intends to embed a concept of "reasonableness" into the Consumer Duty. It plans to apply "reasonableness" to all elements of the Consumer Duty, including the Consumer Principle and it has set out factors to influence what would be a reasonable expectation of firms under the Consumer Duty. The FCA states that this means the rules and guidance must be interpreted in line with the standard that could reasonably be expected of a prudent firm.

However, the tripartite structure of the Customer Duty will require considerable work by many firms. In order to assist firms with this process, the FCA has published substantial draft handbook guidance regarding the Consumer Duty at Appendix 2 to CP21/36.

For individuals, there will be changes to the COCON sourcebook, which will amend the Senior Manager and Certification Regime. These changes include a new Individual Conduct Rule 6 applicable to all conduct rule staff which states that "You must act to deliver good outcomes for retail customers". Where the new individual Conduct Rule 6 applies it will disapply individual Conduct Rule 4 (which requires conduct rules staff to pay due regards to the interests of customers and treat them fairly) because the FCA believes that the new individual Conduct Rule 6 encapsulates and extends individual Conduct Rule 4.

The FCA is also proposing to include additional obligations in COCON which reflect the cross-cutting rules such as:

- You must act in good faith towards retail customers.
- You must avoid foreseeable harm to retail customers.
- You must enable and support retail customers to pursue their financial objectives.

These obligations will also only apply to the extent that it is reasonable and proportionate to expect individuals to meet such requirements. The more senior a person is, and the more relevant their role is to the Consumer Duty, the more the FCA will expect of them to deliver good outcomes to customers.

The FCA has also made it clear that it will not require a single senior manager to be allocated the responsibility of a firm's adherence to the Consumer Duty; it believes that every Senior Manager of the firm is responsible for this.





Practical steps for firms?

From a practical point of view firms will need to carry out a detailed gap analysis to ensure that they understand their obligations and that they can be ready to meet them from the implementation date. The gap analysis and further steps should include items such as the following:

Firm consideration	Summary
Terms and conditions	As the key client document, firms should ensure that these documents are clear and fair and that they aid consumer understanding. Key terms should be explained simply, and important terms should be drawn to a consumer's notice.
Products and services design	Firms may need to review product and service governance processes and make any necessary changes required by the Consumer Duty, including for identifying clear target markets for products and services and set up processes for ongoing governance. Some firms may already have made changes to comply with existing rules in specific sectors, e.g., firms offering certain investment products and insurance
Price and value	Firms may have to review their pricing models to ensure that prices of their product and services meet the price and value outcome.
Customer support	Firms may need to adapt customer service processes and systems to meet the expectations under the Consumer Duty. This could also include IT systems changes and increased staff training.
Customer understanding	Firms may need to introduce new processes to review the language used in key documents, consider how to tailor communication channels or the timing of communications to ensure consumers' understanding and enable consumers to make timely decisions, and test outcomes. Firms may need to set up new processes to test consumer understanding.
Training and development	Firms may need to develop or adapt training programmes to embed the Consumer Duty and consider new rules set out in COCON.
Monitoring and evaluation	Firms will need to monitor and evaluate their compliance with the expectations of the Consumer Duty. Firms may use feedback from customers and staff or carry out reviews of processes and policies. This may also include time spent by board and executive committee members to review and discuss firm approaches to the Consumer Duty in line with their obligations under SM&CR.



What are the next steps for the Consumer Duty?

The FCA will aim to publish a policy statement and make any new rules by 31 July 2022. The Consumer Duty and its associated rules are due to come into force on 30 April 2023.



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