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A new Consumer Duty : FCA Consultation Paper CP21/13

We welcome this consultation paper CP21/13 and its proposed new Consumer Duty, which would set *clearer and higher standards* (para 1.11 of the consultation). For too long, retail consumers of financial products and services have been treated unfairly. Too often, the financial services industry has exploited weaknesses in the financial education, knowledge and behavioural biases of customers to charge excessive fees and deliver unsuitable products.

ShareSoc is a not-for-profit organisation with over 8,000 members. We represent the interests of 5 million individual shareholders and 12 million individual investors in the UK. We are members of Better Finance who, together with our sister organisations in other countries represent individual investors throughout Europe. We are also members of the World Federation of Investors. ShareSoc Chair, Mark Northway, is also Chair of the World Federation of Investors.

Our responses, set out in the following pages, relate solely to shares and funds, and derivatives thereof, unless otherwise specifically stated.

We find it disappointing that the current regime with its guidance of treating customers fairly is not working. We agree that radical change is required to achieve a more satisfactory state of affairs.

We welcome and support your clear statements in para 1.1. that "a new 'Consumer Duty', that would set higher expectations for the standard of care that firms provide to consumers" and " For many firms, this would require a significant shift in culture and behaviour".

We are supportive of the FCA's initiative in this consultation, but are concerned that the proposals will be diluted through industry lobbying. This must not be allowed to happen.

We believe that a Private Right of Action (PROA) as explained in Chapter 5 is crucial to making the new proposals work. Without it, we think that little will change.

Para 2.5 highlights the perceived reticence on the part of the FCA to prosecute and enforce under the Principles unless there is a clear accompanying Rule breach. We believe that the time has come for simplification of the Rules and an increased reliance on, and direct enforcement of, the Principles. This requires cultural change at the FCA.

The document does not adequately address the impact (intended or otherwise) of the proposals on sophisticated individual investors.

We would be pleased to meet with you to explain further our responses.

Yours sincerely

Cliff Weight
Director

Questions in this Consultation Paper and our responses

Q1: What are your views on the consumer harms that the Consumer Duty would seek to address, and/or the wider context in which it is proposed?

We support the FCA's approach.

Q2: What are your views on the proposed structure of the Consumer Duty, with its high-level Principle, Cross-cutting Rules and the Four Outcomes?

We broadly support your approach, although we question the need for the cross-cutting rules.

Q3: Do you agree or have any comments about our intention to apply the Consumer Duty to firms' dealings with retail clients as defined in the FCA Handbook? In the context of regulated activities, are there any other consumers to whom the Duty should relate?

We support the FCA's approach.

Q4: Do you agree or have any comments about our intention to apply the Consumer Duty to all firms engaging in regulated activities across the retail distribution chain, including where they do not have a direct customer relationship with the 'end-user' of their product or service?

We support the FCA's approach. This concept is already embedded in PROD, but it is clear that more needs to be done to ensure that the product provider actively considers the realistic needs and objectives of the end consumer, and takes responsibility for design deficiencies resulting from failure to do so.

Q5: What are your views on the options proposed for the drafting of the Consumer Principle? Do you consider there are alternative formulations that would better reflect the strong proactive focus on consumer interests and consumer outcomes we want to achieve?

We support Option 2:

Option 1: 'A firm must act to deliver good outcomes for retail clients'

Option 2: 'A firm must act in the best interests of retail clients'

Option 2 is the stronger formulation and is most consistent with the creation of a legal duty of care. It falls short of the creation of a fiduciary duty, which we feel would be excessively onerous.

We think the word "best" is unrealistic. The word "best" in the wording, we feel, implies a) an incapacity on the part of the retail client to make his / her own decision and b) a need for providers to be convinced that their proposed product or service represents the absolute best option for the end client. We feel that this goes beyond the intention of requiring the provider to step into the shoes of the consumer.

The word "best" should either be removed or replaced with an adjective which conveys the FCA's underlying intent.

Q6: Do you agree that these are the right areas of focus for Cross-cutting Rules which develop and amplify the Consumer Principle's high-level expectations?

Yes, although we question whether there is indeed a need for cross cutting rules. These will further increase the complexity of the FCA Handbook, will be duplicative of existing rules, and are potentially not needed where the FCA is prepared to enforce or prosecute directly under the proposed Principle.

Q7: Do you agree with these early-stage indications of what the Cross-cutting Rules should require?

Yes, although we question whether there is indeed a need for cross cutting rules. These will further increase the complexity of the FCA Handbook, will be duplicative of existing rules, and are potentially not needed where the FCA is prepared to enforce or prosecute directly under the proposed Principle.

Q8: To what extent would these proposals, in conjunction with our Vulnerability Guidance, enhance firms' focus on appropriate levels of care for vulnerable consumers?

No comment.

Q9: What are your views on whether Principles 6 or 7, and/ or the TCF Outcomes should be disapplied where the Consumer Duty applies? Do you foresee any practical difficulties with either retaining these, or with disapplying them?

No comment.

Q10: Do you have views on how we should treat existing Handbook material that relates to Principles 6 or 7, in the event that we introduce a Consumer Duty?

No comment.

Q11: What are your views on the extent to which these proposals, as a whole, would advance the FCA's consumer protection and competition objectives?

These proposals will improve the quality of products and services to retail consumers, and will ensure more accurate targeting thereof.

Q12: Do you agree that what we have proposed amounts to a duty of care? If not, what further measures would be needed? Do you think it should be labelled as a duty of care, and might there be upsides or downsides in doing so?

We disagree, and are confused as to why the proposal is not specifically labelled as a duty of care. We feel that the FCA has not been sufficiently clear on whether its central proposal is intended to create a duty of care, and we believe this to be a failing in the proposal.

Our preference is for the proposal to be formally labelled a duty of care, and for its legal effect to be consistent with this label.

Q13: What are your views on our proposals for the Communications outcome?

We are pleased to see this expressed an outcome. Historically there has been too much focus on process and not enough on outcomes. Consumers want outcomes and are less worried about process as they do not have the time or knowledge to assess process.

We are, however, concerned that retail consumers of financial services will not be able to distinguish between financial loss and negative outcome. Investing involves risk, and product and service providers cannot, and must not, become responsible for guaranteeing risk outcomes. It is essential that language is formulated which underlines this distinction in the perception of the consumer.

Principle 7 requires firms "to communicate information to customers in a way which is clear, fair and not misleading." Para 4.27 discusses higher expectations. We question why "higher" is needed. We would be happy if the requirement in existing P7 was met. We suggest the FCA questions why P7 has not worked and ask what needs to be done to make P7 work.

We think the information provided to consumers via KIDS needs to be reviewed. (We note that FCA CP21/23 is consulting on PRIIPs)

Para 4.83 highlights the problems of numeracy involving financial concepts. Investors who do not have the necessary financial knowledge or access to financial education cannot evaluate products and risks.

ShareSoc has identified a need for a new, free-of-charge, video-based entry level investing course, and is planning to deliver such a course in 2021. The aim is to cover the key issues that individuals should consider when managing their investments directly.

A brief taster of the course can be found at the link below:
https://www.youtube.com/watch?v=5ek4Pt2LjD4

Interactive Investor has come on board as our first sponsor. LSEG has agreed to endorse the course and help to distribute it so that many people will get the chance to learn from it. We hope that FCA will also consider endorsing the course.

Q14: What impact do you think the proposals would have on consumer outcomes in this area?

We expect firms to move away from lengthy boilerplate language towards a simpler, more consumer-friendly explanation of products and services and their associated risks, costs and reasonable expectations.

The difficulty is that a detailed understanding of complex products often requires a significant and technical explanation. We expect firms to move toward the production of high level (but clear and accurate) consumer guides sitting above detailed technical documents, for example as already seen in the insurance industry.

An example of a possible positive future outcome is that investment advisers would examine some their fundamental assumptions from time to time ,which is a positive.

For example: to examine the issue of whether the 60/40 model may be dead. The default advice from financial advisers is 60% equities and 40% bonds. With very low interest rates and a 40 year bull market in bonds, what has historically been viewed as good advice needs to be revisited.

Q15: What are your views on our proposals for the Products and Services outcome?

We think this is an excellent initiative, although we have some concerns over duplication of existing rules, particularly PROD.

Q16: What impact do you think the proposals would have on consumer outcomes in this area?

We believe the proposals directly address the need for providers to place themselves in the shoes of the consumer when designing products. This directly targets the motivation of providers, and requires profit potential and market opportunity to be consciously weighed against consumer utility and appropriateness.

We feel that the effectiveness of the proposal depends heavily on the creation of a legal duty of care (which we support) and the willingness of the FCA to take action under Principles (which we support).

Q17: What are your views on our proposals for the Customer Service outcome?

We support the FCA’s approach, particularly in the area of exit and switching costs, which we see as a major barrier to competition.

We would comment that while a duty of care places a substantial obligation on a product or service provider to consider the interests of the consumer and to use due skill and care, it does not (and should not) amount to a guarantee that a process will be error-free.

This is to say that a provider's liability under the duty should extend to breaches of the duty, and to the effects of negligent and regulatory diligence or fraud, but not to the effects of genuine unintentional errors which occur in spite of best efforts, which is an unavoidable facet of the financial world.

Q18: What impact do you think the proposals would have on consumer outcomes in this area?

We believe the proposals will improve customer outcomes.

Q19: What are your views on our proposals for the Price and Value outcome?

This is a very important issue for investors and shareholders. The FCA's 2017 Asset Management Market Study highlighted the problems of high charges, high profit margins.

The concept of asking product and service providers to consider value to the consumer is laudable, and signals an intention on the part of the FCA to continue to move the industry away from a demand led product design mentality towards a value proposition, which we support.

However there are perimeter and definition issues which will prove problematic. The proposals potentially have the effect of banning alternative trading mechanisms such as spread betting and CFD on the basis of cost (in aggregate the outcome for CFD users has been shown to be poor), although for certain investors these instruments may represent a positive utility.

We welcome the continued focus on value and its extension throughout the distribution chain.

An example in the investment and savings sector of improved outcomes might be:

- As well as performance data there would also be information on tracking error. We believe the statistical methods for collecting data on tracking error are inadequate at present and we have separately proposed to meet the FCA to explore how improvements can be made in this regard.

- Information on portfolio turnover (e.g. average length shares held, % held more than say 1, 3, 5, 10 years) and benchmarks that reflect the investment strategy of a fund or investment company (e.g. if the portfolio consists of a mixture of large companies and 35% of small high tech/biotech/health companies, then a FTSE 100 benchmark should not be the only benchmark shown). Often more than one benchmark is needed to provide comparisons that retail investors want and need.

Q20: What impact do you think the proposals would have on consumer outcomes in this area?

Value is a difficult concept to police, in particular because it is inextricably linked in the mind of many consumers with financial performance (see parallel comment on outcomes in our response to Q13).

We hope that this initiative will continue to highlight egregious business models.

We caution that an excessive focus on price can have the effect of increasing barriers to market entry. This can result in reduced competition and can increase the pricing power of the larger incumbent producers.

Q21: Do you have views on the PROA that are specific to the proposals for a Consumer Duty?

A PROA will undoubtedly increase the propensity for group legal redress actions in the UK. This is a two-edged sword; the redress industry is frequently parasitic, providing little net value to the investor community, but at the same time the threat of consumer action will undoubtedly influence the mindset and culture of product and service providers.

Woodford, Link and Hargreaves Lansdown have allegedly done severe harm to consumers who invested in the Woodford Equity Income Fund. The stench of Woodford has spread and has done harm to the financial services industry.

The current rules are complex and make claims for redress difficult to pursue. We believe that a PROA is in the interest of consumers.

We disagree with point in para 5.13 that the ability of individual to bring private action will increase costs for firms. Firms that change their behaviour will not incur such costs. Firms that fail to change may find themselves litigated out of business.

Q22: To what extent would a future decision to provide, or not provide, a PROA for breaches of the Consumer Duty have an influence on your answers to the other questions in this consultation?

This is absolutely fundamental. We think that a failure to provide a PROA will result in little change in the culture and mindset of the industry.

Q23: To what extent would your firm's existing culture, policies and processes enable it to meet the proposed requirements? What changes do you envisage needing to make, and do you have an early indication of the scale of costs involved?

No comment.

Q24: [If you have indicated a likely need to make changes] Which elements of the Consumer Duty are most likely to necessitate changes in culture, policies or processes?

No comment.

Q25: To what extent would the Consumer Duty bring benefits for consumers, individual firms, markets, or for the retail financial services industry as a whole?

It would make the industry more sustainable, even though it would reduce overall profitability.

Q26: What unintended consequences might arise from the introduction of a Consumer Duty?

The proposals may have the unintended and undesirable effect of stifling competition. This risk needs to be carefully assessed and monitored.

An outcome-based focus may confuse consumers, who are not equipped to distinguish between product, process and pricing outcomes on the one hand and risk outcomes on the other.

A value-based focus may similarly confuse consumers, who are not equipped to distinguish between the effects of pricing, service and associated performance on the one hand and risk outcomes on the other.

We take the opportunity to underline that all individual investors are not alike, and we caution against a nanny state approach which might have the effect of excluding sophisticated market participants (who do not class as professional investors) from access to certain products, services and markets. Such exclusion might be active (through failing to create appropriate distinctions) or passive (through creating an impression within the industry that such access is frowned upon).

Q27: What are your views on the amount of time that would be needed to implement a Consumer Duty following finalisation of the rules? Are there any aspects that would require a longer lead-time?

No comment.