The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

Consumer & Retail Policy
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

By email: cp21-13@fca.org.uk

26 July 2021

Dear Sir or Madam

FCA Consultation Paper – A new Consumer Duty (CP21/13)

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). The Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

The Committee has studied the Consultation Paper ("**CP**") and wishes to comment upon areas where there is the risk of legal uncertainty, or where the guidance could be clarified.

1. Overlap with existing duties and principles

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?

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?

We consider that the introduction of a new Consumer Duty should be carefully evaluated. While we sympathise with the need to ensure a higher level of consumer protection in retail financial markets, our overall view is that the FCA already has sufficient rules, powers and regulatory initiatives underway to address most of the issues outlined in the CP. A number of the issues identified by the

FCA at CP para 2.13 are already addressed by existing powers, which specify the means for attaining the desired outcomes mentioned at CP paras 2.21 to 2.25. For example,

- Existing product governance rules require that certain products are designed to meet the needs of an identified target market and that reasonable steps are taken to ensure that products are distributed to the identified target market.

- FCA's conduct of business rules require that communications be fair, clear and not misleading and also require firms to act in the best interests of clients – termed honestly, fairly and professionally in COBS, and expressed at a higher level of generality in PRIN 6.

This is by no means an exhaustive list of examples, and there are many other areas of overlap between what has been proposed in the CP and existing rules and regulatory initiatives. One specific instance that the FCA notes is at paragraph 3.36 of the CP states that the Consumer Duty would overlap with existing Principles, particularly Principles 6 and 7. Paragraph 3.40 states that the FCA has not reached a firm view about whether or not to disapply Principles 6 and 7 where the Consumer Duty applies. Our view is that Principles 6 and 7 are already well understood by firms and there is significant guidance available (from Enforcement cases and elsewhere) on what they mean. If Principles 6 and 7 were to be disapplied due to the overlap with the Consumer Duty our view is that this could potentially result in a lack of certainty for the industry with consequent damage to either or both of innovation and consumer outcomes. Similarly, FCA's guidance for firms on their fair treatment of vulnerable customers also provides significant guidelines on how firms should treat vulnerable customers and what types of conduct will be considered to be problematic.

These and other rules and principles are generally understood and a substantial body of regulatory guidance and industry understanding has accumulated in interpreting and applying them. From a perspective of legal clarity and certainty, we consider it would be preferable to extend these (and other) rules to cover a wider range of products and services than effectively supplant them with a new duty cast in different terms. Where there are no material gaps in the FCA's matrix of powers and rules, then we consider that from a legal certainty point of view it is preferable to utilise existing tools with which the industry is familiar rather than introduce new rules and principles at the risk of duplication and consequent confusion.

This position is reinforced by the newly extended application of the fundamental rules of conduct (honesty, integrity and fairness) to all of a financial firm's staff as a result of the senior managers regime. This already places a strong focus on customers' interests and outcomes, while the longer-established Statements of Responsibility, applying a formal "regulatory job description" to each senior manager, help achieve clarity on where responsibilities lie.

We think it is particularly important that the consumer duty does not create legal uncertainty, not only because this is undesirable generally, but also because it may mislead consumers, which is undesirable on consumer protection policy grounds, For instance, if a consumer is misled by the consumer duty into thinking that a firm will protect them in circumstances where, in fact, the consumer duty does not apply, or does not apply in the way that the consumer thinks it does, that will be problematic for the industry and consumers generally. As a concrete example of this, small or medium sized enterprises ("**SMEs**") and local authorities and municipalities can elect to be professional clients in respect of certain products and services ("**elective professionals**"), which will mean that they will lose the benefit of the consumer duty in respect of those products and services while still being treated as a retail client for other products and services. This is directly linked to the issues relating to the scope of the new duty, which we discuss in more detail below.

2. Scope of the new duty

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?

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?

Paragraph 3.4 outlines that the FCA's proposals relate to products and services sold to 'retail clients' which is a wide term that includes all clients other than professional clients and eligible counterparties. Leaving aside the fact that the definition of the term would need to acquire a further limb to include non-clients for the purpose of the duty, there is no unified definition of what "professional clients" and "eligible counterparties" are from which to derive the class of "retail clients". Definitions differ according to the type of business being undertaken – for example, COBS in relation to MiFID and non-MiFID business, while ICOBS uses a completely different categorisation. Even if a COBS classification is adopted, the FCA will need to deal with how elective professionals will be treated – after all the basis for the election to be treated as professionals is for the client to not be treated as a retail client by that firm (though not necessarily for all business) and requiring this to be ignored would be counterintuitive.

To deal with these issues, we suggest that the scope could be limited to individuals and SMEs not engaging with the relevant products in the course of a financial services business (i.e. consumers).

To address Question 4, the principle that some firms that operate exclusively in wholesale markets as part of a distribution chain for retail products or services are subject to the current equivalents of the Consumer Duty is well understood. However, paragraph 3.7 states that the Consumer Duty would apply in circumstances that can include where a firm can, through its regulated activities, influence material aspects of the design, target market or performance of a product or service that will be used by consumers.

We consider that a rule or principle in this form has the potential to cause significant uncertainty and confusion in the industry, as the test of "influence" is broad and unclear. There are many ways in which an industry player in the wholesale market may "influence" the design or performance of a retail product without intention, or even awareness. For example, a market index published by a firm in the wholesale market may influence the pricing of a retail product produced and distributed to consumers by wholly unrelated firms which then has the potential to cause the wholesale firm to be subject to the Consumer Duty under the scope of the new Duty as it is currently described.

There is therefore a need to either (a) reduce the scope of the new Duty or (b) prescribe more detailed guidelines around when and how firms that operate exclusively in wholesale markets may be subject to the new Duty (i.e. what the threshold for "influence" may be), including by publishing concrete examples of the type of activities which would cause firms to be subject to the new Duty. As an alternative, we consider that a refreshing of PROD and RPPR would meet the FCA's objective.

3. Wording of the Consumer Principle

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?

Paragraph 3.12 presents two potential options for the Consumer Principle which are as follows:

> 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'

Our preference is for Option 2.

We are concerned with the wording of Option 1, as achieving "good outcomes" depends on a variety of factors that are outside the control of firms and Option 1 therefore does not lend itself to legal certainty. For example,

- A firm could offer a customer a home loan product that is suitable for their means and requirements at the time but the customer could face drastic changes in their personal circumstances which leads to a bad outcome for the customer.

- An insurer can offer a home insurance policy with exclusions (let us assume fair, and clearly expressed) that operate to leave the customer uncovered in an eventual claim.

- A fund manager offers a balanced growth portfolio, but a market crash results in it losing 20% of its value just when the customer is seeking to realise the proceeds.

In none of these cases will the firm have "acted to deliver" a good outcome; in each case the outcome is positively bad for the customer but through no fault of the firm. Put simply, while firms are able to act in a manner with the intention of delivering good outcomes for customer, the consequences (and therefore, the actual "delivery" of the good outcomes) are entirely outside firms' control which makes it practically difficult for firms to ensure they execute Option 1 or even have reasonable certainty that they have acted in a manner that is compliant with Option 1. If Option 1 is adopted, it would be helpful for the FCA to confirm that outcomes of the kind outlined in our examples above would not be taken as examples of poor outcomes for which firms would reasonably be expected to take responsibility.

In our view Option 1 may also create an unreasonable expectation with customers as to the certainty of any given outcome. Read in plain English, "act to deliver good outcomes" means "make good things happen". This creates a profoundly misleading impression that a retail firm can be required to produce a "good result" for its products and services, with a real probability of actual attainment. This may of course actually happen, in the sense that the insurance policy meets the claim, the loan product is affordable and enables the borrower to meet her goal, and the savings product yields a decent return. But in each of these cases the diametric opposite may occur through no breach by the provider. This indicates two possible necessary amendments to Option 1:

a) A firm must seek to deliver good outcomes for retail clients – this makes it clear that a firm must put itself in a position whereby its products and services can potentially perform as intended, but will not have breached if in any customer's specific circumstances they do not. But there remain two difficulties. First, "good" is subjective, and a customer whose house is repossessed is unlikely to view this as a "good" outcome even if it is objectively appropriate and handled with all possible forbearance. Second, it is misleading to formulate a regulatory requirement so as to indicate that a "good" outcome is in the gift of every firm for every product or service provided to every customer, when clearly it is not.

b) A firm must act to deliver fair outcomes for retail clients – this is far preferable because it is more firmly based in the reality of how financial markets operate, making it clear that a firm must have the right systems and controls in place in product governance, service delivery and post-sales operations to deliver a fair outcome. "Fairness" is an objective standard, making it clear that the view of the provider and customer are relevant, but not necessarily determinative of whether this standard has been met.

If Option 1 is adopted – preferably with our proposed "fair outcomes" amendment – we consider that it would be crucial for the FCA to make it clear to consumers what the limitations of the duty are, and that whilst the duty aims to empower them to make choices for themselves, they remain ultimately responsible for their own decisions and actions, and what the FCA envisages by this. For example, the FCA could provide guidance that consumers are responsible for regularly reviewing their own

situation, devoting time to understand financial products, engaging in honest disclosure, asking questions, responding to information requests, and closing products that are no longer suitable for them, and in turn, encourage firms to build on this guidance in their own communications with customers.

Considering Option 2 from a legal certainty viewpoint, we consider that there exists a volume of guidelines on how firms may act in the best interests of clients, though we note again for completeness that it is largely duplicative of existing COBS and other rules and will for that reason possibly make no practical difference. However, our concern with the wording of Option 2 is that it could be misunderstood as being a fiduciary duty. In this regard we welcome the FCA's comments in paragraph 3.22 that this Option is not intended to create a fiduciary duty and consider this to be very important. We would hope to see this replicated in the commentary on the new Consumer Principle. Notwithstanding this, a court could still find that compliance with a Consumer Principle which adopts the wording in Option 2 creates an express obligation to act in the consumer's best interests, together with a good faith obligation, which then creates a fiduciary relationship.

4. Cross-cutting rules

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?

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

Paragraph 3.25 proposes three key behaviours from firms requiring them to:

1. Take all reasonable steps to avoid causing foreseeable harm to customers
2. Take all reasonable steps to enable customers to pursue their financial objectives
3. Act in good faith

We are concerned that a duty to "take all reasonable steps to avoid causing foreseeable harm to customers" is likely to be judged in hindsight, and does not help set clear expectations on what firms can and cannot do. In explaining what this key behaviour may entail, paragraph 3.25 states that firms should not seek to exploit a customers' vulnerabilities, behavioural biases or lack of knowledge. However, it is unclear how firms could be aware of a customer's vulnerabilities and behavioural biases as these will not always be evident from a customer's records or the way they present themselves; in particular, a non face-to-face transaction may result in only limited information being available. In light of this, we consider that this rule should be made more concrete with clearer expectations on acceptable and unacceptable behaviours. The proposal that benefits and risks are fairly described is, of course, already present in COBS 4, and can be clarified if needed.

We would prefer the FCA to introduce a rule – perhaps as an extension to PROD and RPPR – that firms should not use sales methods that seek to take advantage of customers' vulnerabilities, behavioural biases or lack of knowledge (each of which will require a proper definition, and be backed by examples of good and bad conduct), where these are or should be known to a firm.

Similarly, we also consider that "take all reasonable steps to enable customers to pursue their financial objectives" does not help set clear expectations for firms as many firms would not know a customer's financial objectives unless they undertake advised sales. The reality is that many customers have limited financial skills, as the CP notes at para 4.82. While firms must certainly be precluded from exploiting such weaknesses, we question whether it is practicable to expect firms to identify and enable customers to pursue financial objectives that they may themselves be aware of.

We have no concerns over a key behaviour requiring firms to "act in good faith", though we again note that it largely duplicates PRIN 1 and 2.

5. The four outcomes

a. Requirement that communications enable consumers to make informed decisions

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

We have no concerns over this proposal, although we consider that these rules are better contained in COBS 4 rather than possibly fragmented between COBS 4 and the proposed new rule.

b. Requirement that products and services are fit for purpose

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

We have no concerns in relation to this rule, but again note that (as the FCA observes) it largely replicates existing rules. We consider that, for reasons of convenience, consolidation of similar requirements, and hence of legal certainty, that it would be preferable to expand the existing provisions rather than replace or duplicate them.

c. Requirement that firms provide good customer service

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

We would have no concerns over such a rule. We would, however, observe that it would be preferable to express it positively, for instance "A firm's customer service [to be defined] should be designed and delivered to assist a customer to realise the benefits of their product or service" rather than negatively – the present suggestion is "do not unduly hinder".

d. Requirement that prices represent fair value

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

Paragraph 4.86 states that FCA proposes to introduce a requirement that firms set prices so that they represent fair value for their target customers. We consider that it would be difficult for firms to understand with sufficient clarity what "fair value" may entail, leading to uncertainty and confusion and irregularities in the way the requirement is practically implemented by the industry. However, establishing more detailed guidelines on what "fair value" is beyond what currently exists in an attempt to introduce clarity would require the FCA to effectively prescribe what profit margins will be considered to be fair, which would require it to be a price regulator across the entire financial services industry. We do not consider this to be the intended nor the desirable outcome, and query whether it would be consistent with the FCA's current powers.

6. Private right of action

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

Paragraph 5.2 states that the FCA view the private right of action as part of a wider range of mechanisms which make firms accountable for their breaches of FCA rules, and by which consumers can get redress.

As a first point, many of the concepts outlined in the CP do not generate legal certainty, and therefore do not allow for sufficient certainty for firms to assess whether a potential cause of action may arise against them. Introducing private right of action for concepts that lack clarity is likely to cause industry-wide uncertainties as firms will be unable to accurately assess either the required level of compliance, or the level of claim risk.

Separately, there is of course no right of action for breach of a Principle. It is generally accepted that, since their introduction over 30 years ago, the Principles are broadly phrased statements of fundamental objectives and enduring standards that serve to address the intention of regulation. They have been accepted by, and guide, the industry on this basis, and they have been used by the regulators in countless enforcement cases and instances of supervisory action. But they are not suitable as a basis for individual legal action for the very reason that underlies their regulatory utility – they are high level and generalised statements that are not intended to provide the certainty of outcome that is needed to enable firms to understand and meet a directly enforceable legal requirement.

We nonetheless acknowledge that if Option 2 of the Consumer Principle is adopted, then this will be an equivalent provision to the duty to act in the client's best interests which already exist in COBS, ICOBS and MCOBS with an accompanying right of action at the suit of a private investor. We query whether this is in line with the policy intent. If it is, we consider that this private right of action is better accommodated in a rule rather than a unique Principle which alone can be actioned. In any case our view is that FOS is a much more cost-effective and quicker route for consumers to obtain redress than civil litigation and that accordingly it is questionable whether the private right of action would prove to be a real benefit for consumers.

On balance, we therefore do not consider the introduction of the private right of action to be suitable.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours faithfully

Karen Anderson
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
REGULATORY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Karen Anderson (Chair, Herbert Smith Freehills LLP)
Matthew Baker (Bryan Cave Leighton Paisner LLP)
Peter Bevan (Linklaters LLP)
Chris Borg (Reed Smith LLP)
Simon Crown (Clifford Chance LLP)
Richard Everett (Travers Smith LLP)
William Garner (Charles Russell Speechlys LLP)
Angela Hayes (TLT LLP)
Mark Kalderon (Freshfields Bruckhaus Deringer LLP)
Ben Kingsley (Slaughter and May)
Anthony Ma (Grant Thornton UK LLP)
Brian McDonnell (McDonnell Ellis LLP)
Hannah Meakin (Norton Rose Fulbright LLP)
Simon Morris (CMS Cameron McKenna Nabarro Olswang LLP)
Rob Moulton (Latham & Watkins LLP)
Julia Smithers Excell (White & Case LLP)