

# **Discussion Paper on a duty of care and potential alternative approaches**

Discussion Paper  
DP18/5

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## Executive Summary

In our Mission 2017<sup>1</sup>, we explained how and why we prioritise, protect and intervene in financial markets. We also set out our intention to be more transparent and accountable for the way in which we carry out our role.

Parliament has given us a single strategic objective – to ensure that relevant markets function well – and 3 operational objectives, one of which is securing appropriate protection for consumers. To deliver these objectives, Parliament has given us a range of tools. As a regulator, we use these tools to prevent harm from occurring, and use them to tackle harm when it arises.

Consumers get the best outcomes from markets when they are treated fairly. The FCA's Principles for Businesses in our Handbook (our Principles) apply to most authorised firms and include the Principle of 'treating customers fairly'. Our Handbook also requires that firms act in the best interests of their clients in certain circumstances.

Our Principles are clear that firms are responsible for making sure that all their customers are treated fairly. This also applies to firms that do not have direct contact with retail customers. We expect all firms to exercise extra care where consumers may be vulnerable.

While we have regard to the general principle that consumers should take responsibility for their decisions<sup>2</sup>, we know that there are factors that might limit their ability to do so. Our regulatory and legal framework recognises that different consumers may have different degrees of experience and expertise and that the level of care provided by firms should be appropriate for their capabilities<sup>3</sup>. We expect firms to frame decisions for customers based on real consumer behaviours and not to exploit biases. For consumers, businesses and regulation this is a challenging balance to strike.

Some stakeholders have voiced concerns that our regulatory framework, including our Principles, may not be sufficient or applied effectively to prevent harm to consumers and protect them appropriately. Some have said that the introduction of a duty of care could reduce harm by requiring firms to avoid conflicts of interest, as well as supporting longer-term cultural change within firms.

Other stakeholders have suggested that existing FCA rules already provide sufficient protections for consumers and impose the same requirements on firms that a duty of care would.

Given these differing views and the strength of the concerns expressed, it is important that we have an open discussion and debate about the potential merits of a duty of care. We must also ensure we understand the consequences of any changes we may make.

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<sup>1</sup> Our Mission 2017 - [www.fca.org.uk/publication/corporate/our-mission-2017.pdf](http://www.fca.org.uk/publication/corporate/our-mission-2017.pdf)

<sup>2</sup> See section 1C(2)(d) of the Financial Services and Markets Act 2000 ('FSMA').

<sup>3</sup> Section 1C(2)(b) and (e) of FSMA.

We have a responsibility to consider, and be open to, alternative approaches that might address stakeholders' concerns and we use the term 'New Duty' in the Paper to encompass a duty of care and alternative approaches.

In our Approach to Consumers paper, published alongside this, we commit to keeping our powers and tools and how we use them under review, to ensure we are working effectively to protect consumers. This Discussion Paper forms part of that commitment.

We are publishing this Discussion Paper to:

- Help us better understand whether there is a gap in our regulatory and legal framework, or the way we apply it in practice, that could be addressed by introducing a New Duty.
- Assess whether change is desirable and, if so, what form it could take, how it would work in practice alongside our current framework, and what consequences it would have for consumers, firms and the FCA.
- Better understand and consider possible alternative approaches that might address stakeholders' concerns.
- Understand what a New Duty for firms might do to enhance good conduct and culture in financial services, and how this could influence consumer outcomes, alongside the Senior Managers and Certification Regime (SM&CR).

We provide an overview of the existing regulatory and legal framework within which we operate, and seek views on potential changes through a New Duty. We illustrate how we apply this framework in practice using our suite of powers and tools and ask whether this is being effective in preventing harm to consumers.

We also explain the various routes by which consumers can currently obtain redress when harm does occur, such as the Financial Ombudsman Service. We consider whether a New Duty would provide an additional route by which consumers could secure redress, and whether that is needed.

### **Who will be interested in this Discussion Paper?**

We invite views from all parties with an interest in this issue. This includes:

- consumer groups and individual consumers
- industry groups / trade bodies
- regulated firms
- policy-makers and regulatory bodies
- industry experts and commentators
- academics and think tanks

### **Next steps**

We welcome discussion and feedback on this important and complex debate. We ask for views, including responses to our questions, by 2 November 2018. Details on how to respond are on page 34.

# 1. Introduction

## Our vision

We carry out a significant amount of work to identify proactively the harm that is caused to consumers and to understand what drives it, so we can intervene effectively to address actual or potential harm.

Our Mission, published in 2017, made it clear that consumer protection lies at the heart of everything we do. Our Approach to Consumers, published alongside this discussion paper, provides further clarity about the actions we will take to protect consumers, including those in more vulnerable circumstances.

In our Approach paper, we set out our vision for well-functioning markets for consumers and commit to keep our powers and tools and how we use them under review, to ensure we are working effectively to protect consumers. The Approach paper sets out how we prioritise our interventions and how we use our powers and tools. These include our Principles for Businesses (the 'Principles'), set out in further detail in Section 2 below.

## Calls by some stakeholders for a duty of care to improve consumer outcomes

Some stakeholders have raised concerns that our current regulatory framework does not provide adequate protection for consumers. They have called for the introduction of a 'duty of care' on firms when dealing with consumers. It has been suggested by some that the extent and longstanding nature of consumer detriment indicates that cultural change is required within firms and the market as a whole. They consider that current regulation has not yet delivered the change required, and that a duty of care would do so.

In calling for a new duty, some stakeholders have suggested that it should be a 'fiduciary duty' and some have suggested it should be a 'duty of care'. Sometimes the proposed new duty has been expressed in a way that incorporates concepts from the legal definitions of both 'duty of care' and 'fiduciary duty'. The legal definition of a 'duty of care' is an obligation to exercise reasonable care and skill when providing a product or service. A 'fiduciary duty' is complex to define but means, broadly, that firms must not put personal interests above those of the client, must avoid conflicts of interest and must not profit from the firm's position without the client's knowledge and consent. We provide further description of the concepts in Annex 1.

### **Our definition in this paper of a New Duty**

A duty of care and a fiduciary duty, therefore, have somewhat different purposes. A duty of care is a positive obligation whereas a fiduciary duty is largely a prohibition. In this paper, we use a 'New Duty' to cover all possible formulations of any new duty of care or fiduciary duty on firms and any other changes that could address stakeholders' concerns.

In the consultation on our Mission 2017, we asked the question 'would a duty of care help ensure that financial markets function well'<sup>4</sup>. We received a range of differing responses<sup>5</sup>. Several respondents also expressed views on this issue as part of our later consultation on our Future Approach to Consumers<sup>6</sup>. These focused largely on the treatment of retail consumers, but there is a question as to whether any New Duty could also apply to wholesale markets.

Some respondents said that they believe that a duty of care would operate as a preventative measure to protect consumers, obliging providers of financial services to avoid conflicts of interest and act in customers' best interests. They stated their view that the existing Principles do not remove conflicts of interest and do little to deter firms from mis-selling products and services.<sup>7</sup>

Some respondents also argued that once poor conduct is found, consumers have to face a lengthy battle to obtain redress. They explained that if firms had a legal duty of care to customers, it would help achieve better outcomes in the first instance.

Broadly, these concerns show that a number of stakeholders are dissatisfied with the consumer outcomes they have seen in the markets we regulate. They see these as being either due to our framework not being sufficiently clear or not being applied effectively. They put forward a duty of care as a solution which would promote responsible behaviour on the part of businesses, ensuring fairer outcomes for consumers (particularly the vulnerable) and an improvement in firm culture.

### **But other stakeholders disagree**

Some respondents said that existing FCA rules and common and statute law, now complemented for some firms by the Senior Managers & Certification Regime ('SM&CR'), which is being extended, already require firms to follow good business practice and that collectively they represent in practice the same requirements on firms as a duty of care.

Some stakeholders said that a duty of care would result in firms introducing a new set of highly complex rules for staff to understand and follow and these changes could result in additional and unnecessary layers of complexity and uncertainty. Some said this could have an effect on their product provision and approach to innovation. This would result from a real or perceived increased risk to firms of costly and extensive legal action, with potentially large redress payments being passed on as increased costs to consumers<sup>8</sup>.

Respondents also suggested that the definition of what would constitute a reasonable duty of care could be difficult to achieve. They explained this would be burdensome to develop and likely to be very detailed to cover all potential relationships with customers, which could only be clarified and tested through claims in court.

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<sup>4</sup> <https://www.fca.org.uk/publication/corporate/our-future-mission.pdf>

<sup>5</sup> [Our Mission 2017: Feedback Statement FS17/1](#), April 2017, FCA.

<sup>6</sup> See [www.fca.org.uk/publication/corporate/our-future-approach-consumers.pdf](https://www.fca.org.uk/publication/corporate/our-future-approach-consumers.pdf). The summary of responses is contained in our Feedback Statement annexed to the Approach to Consumers, 2018, published alongside this document.

<sup>7</sup> See for example the briefing paper of the Financial Services Consumer Panel: A duty of care for financial services providers, January 2017 at [www.fs-cp.org.uk/sites/default/files/duty\\_of\\_care\\_briefing\\_-\\_jan\\_2017.pdf](http://www.fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017.pdf).

<sup>8</sup> [Our Mission 2017: Feedback Statement FS17/1](#), April 2017, FCA.

We are grateful to stakeholders who have already submitted views to us. We recognise the concerns expressed both for and against a duty of care and the importance and complexity of the debate.

### **The purpose of this paper**

In our Mission 2017, we committed to produce a Discussion Paper to explore the potential merits of a duty of care as part of our Handbook Review following the UK's exit from the EU in 2019. We stated that it would be difficult to make extensive changes to the FCA Handbook at the same time as undertaking the major overhaul needed to put the EU Withdrawal legislation into effect.

We recognise the wider debate on this issue, including feedback received on this topic following our Future Approach to Consumers 2017. Launching this Discussion Paper now will help us understand more fully what outcomes a New Duty might be able to achieve and what a New Duty for firms in financial services might do to enhance behaviour in the financial services market.

We have a responsibility to consider and be open to alternative approaches that might address stakeholders' concerns. We must also consider operational implications and avoid unintended consequences of any changes we make: for example, by introducing complexity or confusion to the current regulatory regime. We welcome an open debate on this issue to help us to assess whether change is desirable and, if so, what form it could take.

## 2. Our regulatory and legal framework

When considering the potential merits of a New Duty, we want to understand whether our existing regulatory framework and the standards that we apply to firms (and, in some cases, to individuals) are fit for purpose in delivering the right outcomes for consumers.

To deliver our objectives, Parliament has given us a range of tools. As a regulator, we use these tools to prevent harm from occurring or tackle it when it has already arisen.

Some stakeholders have raised concerns that our current regulatory framework does not provide adequate protection for consumers. Some of the gaps identified include our existing Principles, which they said do not remove conflicts of interest. As such, stakeholders have said they are insufficient to deter firms from mis-selling products. They also said that the current framework does not go far enough in improving and incentivising good conduct and culture in firms. They suggested that a duty of care could bring benefits to these areas, by providing an additional incentive to firms to behave in a way that benefits all consumers.

In this section, we set out the framework within which we operate, the standards that we apply to firms and the powers we have to protect consumers. This is to help understand whether our existing framework is sufficient to enable us to protect consumers, or whether there are gaps that a New Duty (whether a duty of care or other change) could address.

### Our objectives

Under the Financial Services and Markets Act 2000 ('FSMA') we have a single strategic objective<sup>9</sup> which is to ensure that relevant markets function well. This is underpinned by 3 'operational objectives':

- to secure an appropriate degree of protection for consumers<sup>10</sup>
- to protect and enhance the integrity of the UK's financial system
- to promote effective competition in the interest of consumers

When carrying out certain functions, including making rules, we must act to advance one or more of those objectives. The need to advance one or more operational objectives will be relevant to any decision by the FCA to introduce a New Duty.

### FCA regulatory perimeter and rule-making powers

Regulated financial services (referred to as 'regulated activities'<sup>11</sup> or the 'FCA's perimeter') include activities related to a number of sectors including banking, consumer

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<sup>9</sup> Section 1B of FSMA.

<sup>10</sup> The meaning of 'consumer' is limited in this context and the emphasis is on persons who use, may use, or have used, regulated financial services or have invested, or may invest, in financial instruments.

<sup>11</sup> These are set out in detail in the Financial Services and Markets Act 2000 (Regulated Activities) Order.

credit, pensions, investments, asset management and insurance. Persons who are licensed, or otherwise permitted, to perform such activities are 'firms'<sup>12</sup>.

We have the power to make rules applying to firms for both their regulated and unregulated activities<sup>13</sup>. These rules can apply to both retail and wholesale transactions. Our focus is primarily on regulated activities when advancing the operational objectives of consumer protection and promoting competition. The unregulated activities of a firm may, however, still be relevant<sup>14</sup> and, in some circumstances, we may take action or refer matters to other bodies who have relevant responsibilities in these areas.

There have been a number of cases where we have been asked to intervene in relation to unregulated activities or where uncertainty about our role has raised questions about what we do and do not regulate. Concerns about our role in these areas have been one of the factors driving calls for the introduction of a duty of care.

Examples of where this has occurred include:

- commercial lending (which is not a regulated activity unless it constitutes consumer credit)
- cryptoassets (which are not regulated investments themselves, although derivative contracts that reference cryptoassets and certain cryptoasset tokens, for example, may be)
- mortgage purchasers (who are not required to be regulated, as long as they employ an authorised third party to 'administer' the mortgage contracts)<sup>15</sup>

Any introduction of a New Duty, or expansion of the scope of any of our existing rules (such as those requiring firms to act in the best interests of consumers), would be limited by the extent of our rule-making powers and would not address concerns about areas that we do not regulate (such as those described above). Intervention in these areas would require Government legislation.

## **Current FCA rules**

### Outcomes-focused regulation

Our regulation is outcomes-focused and is based on a combination of the Principles<sup>16</sup>, other high-level rules and, where necessary, detailed rules and guidance. Some have been introduced through domestic policy and some as a result of implementation of EU directives.

The Principles act as a general statement of the fundamental obligations of firms reflecting our operational objectives. The Principles are then amplified in more detailed rules and guidance (the effect of which is discussed below) to address particular

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<sup>12</sup> While the FCA also has responsibilities for other types of regulated financial services under FSMA and outside of FSMA, this discussion paper is concerned with our regulation of the regulated activities of firms.

<sup>13</sup> A number of our Principles for Businesses, for example, encompass the unregulated activities of firms.

<sup>14</sup> For example, whether they meet the Threshold Condition on suitability at authorisation and subsequently.

<sup>15</sup> For further information and other examples, see [this letter](#) from the FCA to the Treasury Select Committee dated 30 January 2018.

<sup>16</sup> Set out at PRIN 2.1 in the FCA's Handbook.

circumstances. This combination of Principles, rules and guidance allows us to apply a range of tools and protections that are appropriate in different situations.

### **Increasing transparency and engagement at renewal**

Our mandatory renewal disclosure rules for insurers are an example of our Principles, rules and guidance-based approach to regulation. These rules amplify Principles 6 (treating customers fairly) and 7 (communicating in a way that is clear, fair and not misleading). In April 2017 we introduced rules<sup>17</sup> to require firms to disclose, in particular, the previous year's premium at renewal in a clear manner so that consumers can easily compare this with the new renewal quote. At the same time, we issued guidance under Principle 7 encouraging firms to review whether the language used in their renewal notice could risk discouraging customers from shopping around.

The overarching framework of the Principles is necessary because the detailed rules cannot constitute an all-embracing comprehensive code of regulation that covers all possible circumstances. Any code that tried to be exhaustive could be circumvented, could contain provisions which are unsuitable for the many and varied circumstances which arise in financial services and could also stifle innovation. So, even in areas where there are detailed rules, a firm must continue to comply with the Principles. In this way, the Principles can deal with situations or issues that are not specifically envisaged by the detailed rules.

However, the success of this approach depends on a number of factors which we discuss in more detail below and in Section 3:

- We must have the right Principles and detailed rules in place.
- Firms must understand what is expected of them.
- We must use our authorisation, supervision and enforcement tools effectively.
- Firms must have the right culture, particularly at senior management level, so that the standards of conduct set out in the Principles are at the heart of their approach.

### Principles for Businesses

These generally apply to all firms in respect of their regulated activities<sup>18</sup>. The most relevant in the context of a New Duty are:

- **Principle 2** Skill, care and diligence – A firm must conduct its business with due skill, care and diligence.
- **Principle 6** Customers' interests – A firm must pay due regard to the interests of its customers and treat them fairly.
- **Principle 7** Communications with clients - 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.

<sup>17</sup> [Increasing transparency and engagement at renewal in general insurance markets: PS16/21, March 2017](#), and Insurance Conduct of Business (ICOBS) rule 6.1.12AR (3).

<sup>18</sup> See PRIN 3.1.1R and 3.2.1AR which notes that they can also apply in some other circumstances. Their application is also subject to exemptions and modifications, such as compliance with EU law.

- **Principle 8** Conflicts of interest – A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
- **Principle 9** Customers: relationships of trust – A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.

The FCA expects firms to exercise judgment about and take responsibility for what the Principles mean for them in terms of how they conduct their business. A breach of a Principle will make a firm liable to disciplinary action<sup>19</sup>. Where the FCA considers it appropriate, it will take enforcement action against a firm on the basis of the Principles alone<sup>20</sup>, as described in Section 3 below.

Some of the Principles described above, together with the detailed rules and guidance (the effect of which we describe below), could be said to address many of the issues that are cited as reasons for introducing a New Duty. For example, Principle 2 addresses the standard of care that firms must adopt, Principle 6 deals with fair treatment of consumers and Principle 8 requires firms to manage conflicts of interest fairly.

'Client's best interests' and other rules

The Principles are amplified by a large number of rules in the Handbook, some are detailed and others are more high level. In particular, there are a number of high-level rules in the FCA Handbook which require a firm to 'act honestly, fairly and professionally in accordance with the best interests of its client'. These 'client's best interests' rules derive from EU directives and apply to: designated investment business<sup>21</sup>, mortgage activities<sup>22</sup> and, from implementation of the Insurance Distribution Directive in October 2018, insurance distribution<sup>23</sup>. There are also more specific 'best interests' rules in our Consumer Credit Sourcebook (CONC)<sup>24</sup>. The main regulated areas where there are no such 'client's best interests' rules are accepting deposits and carrying out contracts of insurance.

There are also a number of FCA rules that contain an obligation on firms to take 'reasonable care' for certain activities<sup>25</sup>.

## Guidance and other supporting materials

In some cases, the Principles and detailed rules are amplified by guidance. Guidance can be used to explain the implications of other provisions or recommend a particular course of action.<sup>26</sup> This may be supplemented by other supporting materials, such as case

<sup>19</sup> PRIN 1.1.7G.

<sup>20</sup> EG 2.8.2 and DEPP 6.2.14G.

<sup>21</sup> COBS 2.1.1R, there is also an obligation in COLL 6.6A in relation to duties of Authorised Fund Managers

<sup>22</sup> MCOB 2.5A.1R

<sup>23</sup> COBS 2.1.1 and ICOBS 2.5.-1R from implementation of the Insurance Distribution Directive on 1 October 2018.

<sup>24</sup> For example, at CONC 2.5.8R, 3.8.3G, 6.7.19R, 8.3.2R and 8.6.1R.

<sup>25</sup> For example, ICOBS 5.3.1R which requires a firm to take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely upon its judgment.

<sup>26</sup> Guidance is not binding and need not be followed to comply with the relevant rule or requirement, but if a person acts in accordance with general guidance they are treated as having complied with the rule or requirement to which it relates, see [www.fca.org.uk/publication/handbook/readers-guide.pdf](http://www.fca.org.uk/publication/handbook/readers-guide.pdf)

studies showing good or bad practice, FCA speeches, and generic letters written by the FCA to chief executive officers in particular regulated sectors. All of these materials are intended to improve firm conduct and compliance with the regulations.

As an example of supporting material, Principle 6 on 'treating customers fairly' is supported by 6 customer outcomes (set out in Annex 2). Our predecessor, the Financial Services Authority (FSA), introduced these outcomes in 2006 to explain this long-standing Principle and help ensure that firms focus on what it is intended to deliver. The FSA subsequently provided examples of good and bad practice, a guide to help firms develop management information and measured firms' progress on this Principle and the associated outcomes (which became embedded in our core supervisory work). Our Approach to Consumers document explains that these outcomes still set the baseline of our expectations of how firms should treat consumers and what consumers can expect to see when firms are treating them fairly.

Another example of guidance on fair treatment is provided in 'The Responsibilities of Providers and Distributors for the Fair Treatment of Customers' (RPPD)<sup>27</sup>. In this guidance we give our view on what the combination of Principles and detailed rules require of providers and distributors in certain circumstances to treat customers fairly. It looks particularly to Principles 2 (due skill, care and diligence), 3 (management and control), 6 (treating customers fairly) and 7 (client communications) in describing the respective responsibilities of providers and distributors in various stages of the product life-cycle or the provision of a service.

### **Consumer protection legislation**

In addition to the powers given to us in FSMA, we are given certain powers under the Consumer Rights Act 2015 ('CRA') and under other legislation. This includes under Part 8 of the Enterprise Act 2002, the power to enforce breaches of certain consumer protection laws (including in respect of the Consumer Protection from Unfair Trading Regulations 2008, the 'CPRs').

The CRA implies into every contract for a trader supplying a service to a consumer a term saying that the trader must perform the service with reasonable care and skill<sup>28</sup>. This cannot be excluded by the trader and is enforceable by the consumer either under general law or specifically under the CRA. We discuss remedies available to the consumer in Section 4 below. The 'reasonable care and skill' requirement could be said to be similar to the requirements of a duty of care (as described in Annex 1).

The CRA also provides that in contracts between a trader and a consumer, an unfair term or notice is not binding on a consumer. The test for unfairness is whether, contrary to the requirement of good faith, the term or notice causes a significant imbalance in the parties' rights and obligations to the detriment of the consumer<sup>29</sup>.

The CPRs prohibit unfair commercial practices, such as misleading consumers or aggressive commercial practices. They apply to commercial practices before, during and after a commercial transaction. With the exception of some consumer credit matters,

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<sup>27</sup> FCA regulatory guide at [www.handbook.fca.org.uk/handbook/document/RPPD\\_FCA\\_20130401.pdf](http://www.handbook.fca.org.uk/handbook/document/RPPD_FCA_20130401.pdf)

<sup>28</sup> Section 49 of the CRA.

<sup>29</sup> Part 2 of the CRA.

consumers do not have rights to claim redress for breach of the CPRs arising from regulated activities<sup>30</sup>.

## **Competition law**

Under FSMA we can investigate markets where competition may not be working well for consumers, and intervene where appropriate, for example, by making rules for firms that we regulate.

The FCA has also been given concurrent competition powers with the Competition and Markets Authority (CMA) in relation to the provision of financial services. This means we also have powers under the Enterprise Act 2002 to investigate whether competition in any market for financial services is working well, expanding our powers beyond those firms and activities that we currently regulate. This allows us, for example, to require firms to provide information and to make a market investigation reference (MIR) to the CMA to investigate a particular market or sector in more depth.

Under our concurrent powers we also have powers to investigate and enforce against breaches of the major prohibitions under the Competition Act 1998 (CA98) and equivalent EU provisions in relation to the provision of financial services<sup>31</sup>. We discuss with the CMA who is best placed to do so and seek to reach agreement as to which authority the case should be allocated to, but ultimately the decision rests with them.

## **Culture and accountability and the Senior Managers & Certification Regime (SM&CR)**

Alongside these powers and tools, culture and governance is a continuing priority for us across all sectors, helping us to guide our work and prioritise our interventions in order to deliver our operational objectives.

Firms' culture and governance can either drive or mitigate harm to consumers and markets, leading to either negative or positive outcomes. One reason that has been put forward for a New Duty is that it would improve culture in firms, driving better practices and behaviours.

The SM&CR marks an important change to our framework and a key tool to improve the culture of authorised firms and raise the standard of conduct in financial services.

We introduced the SM&CR for deposit takers in March 2016<sup>32</sup>. This followed recommendations from the Parliamentary Commission on Banking Standards, which was tasked with reviewing standards of behaviour in the industry following the financial crisis in 2008<sup>33</sup>. Parliament recommended that we develop a new accountability system that was more focused on senior managers and individual responsibility. From these recommendations, we created the SM&CR, which we applied to banks, building societies,

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<sup>30</sup> Regulation 27D of the CPRs.

<sup>31</sup> The prohibition of anti-competitive agreements under section 2(1) CA98 and Article 101 of the Treaty on the Functioning of the European Union (TFEU); and the prohibition of abuse of a dominant position under s.18(1) CA98 and Article 102 TFEU.

<sup>32</sup> [www.fca.org.uk/firms/senior-managers-certification-regime](http://www.fca.org.uk/firms/senior-managers-certification-regime), this replaced the Approved Persons Regime (APR) for banks, building societies, credit unions and dual-regulated (FCA and PRA regulated) investment firms.

<sup>33</sup> [Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms](#), CP 17/25, FCA, July 2017.

credit unions and investment firms designated by the Prudential Regulation Authority from March 2016.

The SM&CR places obligations on individuals as well as firms, and its aim is to make all financial services employees more accountable for their conduct and competence. In 2017, we consulted to extend the SM&CR to all FSMA-authorized firms. The Treasury has confirmed it will apply to insurers from 10 December 2018. It will apply to all other FSMA-authorized firms from 9 December 2019<sup>34</sup>.

For those firms to whom the SM&CR applies, we have set out our expectations of firms and the behaviour of their employees. As part of this, most employees will be subject to 5 conduct rules that represent minimum standards of behaviour.

Employees must<sup>35</sup>:

- act with integrity
- act with due care, skill and diligence
- be open and co-operative with regulators
- pay due regard to the interests of customers and treat them fairly
- observe proper standards of market conduct

Firms need to train their staff on the requirements and notify us where disciplinary action has been taken against a person in the event of a breach of these rules. Under the SM&CR, given the decision-making role they have, senior managers are subject to 4 additional conduct rules relating to effective control, regulatory compliance, appropriate delegation and appropriate disclosure to regulators<sup>36</sup>.

We expect its introduction to bring a necessary and significant change, improving culture and accountability. For these reasons, while the regime has only recently been implemented for deposit-takers (and will be implemented later in 2018 for insurers and in 2019 for all other FSMA-authorized firms), the additional obligations it places on individuals in firms could help to address some of the key cultural and governance concerns that lie behind calls for a New Duty.

As the regime embeds, we hope and expect to see positive change and we will continue to evaluate its long-term impact. We are keen to understand whether it could address the outcomes that a New Duty has been said to achieve. If respondents feel this is insufficient, we are keen to understand why and what further regulation respondents may feel is needed to enhance good conduct and culture in firms and influence positive customer outcomes.

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<sup>34</sup> [PS18/14: Extending the Senior Managers and Certification Regime to FCA firms – Feedback to CP17/25 and CP17/40, and near-final rules](#), FCA, July 2018. The rules published are near-final as they are subject to commencement regulations to be made by the Treasury.

<sup>35</sup> Code of Conduct (COCON) 2.1.

<sup>36</sup> Code of Conduct (COCON) 2.2.

Further information on the SM&CR is outlined in our Approach to Supervision<sup>37</sup>. We also explain in Section 3 below our focus on culture and governance in our authorisations and supervisory work.

### **Regulating for changing consumer needs**

We collect a large range of insight, information and evidence to help assess whether our tools are working effectively to protect consumers and identify areas where further intervention may be required to prioritise and inform our work.

Research projects, such as our Financial Lives Survey 2017<sup>38</sup> and Occasional Papers on subjects such as Vulnerability<sup>39</sup>, Access to Financial Services<sup>40</sup> and the Ageing Population and Financial Services<sup>41</sup>, provide us with insights and information about who might be vulnerable and where harm may be occurring.

We publish our Sector Views annually<sup>42</sup>, providing the latest information and analysis of what has been happening in the external environment. We use these and other intelligence sources to identify emerging issues and areas where we need to intervene.

This helps us to identify instances where financial services markets or firms have the potential to harm users, or where they are working poorly and not providing sufficient benefit.

### **Keeping our standards under review**

Our Approach to Consumers, published alongside this paper, sets out our vision for well-functioning markets for consumers. This explains that we will address harm or potential harm by using the most effective powers and tools in the circumstances. We will also continue to review and adapt how we use our powers and tools, including our rules and guidance, to ensure we deliver good outcomes for consumers.

Where we identify areas of harm (for example through research, market studies or our supervisory work) which are not adequately covered by our existing detailed rules, we may either rely on the Principles to take supervision or enforcement action, or we may introduce new detailed rules, or develop guidance to clarify our expectations.

The decision to rely on the Principles or make new rules will depend on a number of factors. This includes whether the Principles alone will be effective in preventing the identified harm or whether more detailed rules are required to achieve this.

Alternatively, where the conduct causing the harm is closely linked to existing rules (either Principles or more detailed rules), then guidance may be sufficient to prevent further harm.

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<sup>37</sup> Our Approach to Supervision, [www.fca.org.uk/publication/corporate/our-approach-supervision.pdf](http://www.fca.org.uk/publication/corporate/our-approach-supervision.pdf)

<sup>38</sup> [www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf](http://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf)

<sup>39</sup> FCA, Occasional Paper No. 8: Consumer Vulnerability, February 2015 [www.fca.org.uk/publication/occasional-papers/occasional-paper-8.pdf](http://www.fca.org.uk/publication/occasional-papers/occasional-paper-8.pdf)

<sup>40</sup> FCA, Occasional Paper No. 17: Access to Financial Services in the UK, May 2016 [www.fca.org.uk/publication/occasional-papers/occasional-paper-17.pdf](http://www.fca.org.uk/publication/occasional-papers/occasional-paper-17.pdf)

<sup>41</sup> DP16/1 Ageing Population and Financial Services - [www.fca.org.uk/news/dp16-01-ageing-population](http://www.fca.org.uk/news/dp16-01-ageing-population)

<sup>42</sup> FCA, Sector views, 2017 [www.fca.org.uk/publication/corporate/sector-views-2017.pdf](http://www.fca.org.uk/publication/corporate/sector-views-2017.pdf)

For example, following the 'General Insurance Add-ons Market Study' in 2016, we introduced a ban on opt-out selling of add-ons and issued guidance to clarify our requirements and encourage improved selling practices<sup>43</sup>.

Following the Asset Management Market Study in 2017<sup>44</sup> we brought in new rules to strengthen the requirement for authorised fund managers to act in the best interests of investors. This is through a combination of introducing independent members to the governing boards of these firms and introducing a new responsibility under the SM&CR. We believe that these rules will influence the culture of authorised fund managers in a way that leads to better results for investors.

### **A duty of care in other sectors and internationally**

We have discussed above the framework within which we operate and the standards that we apply to firms. There are also a number of other sectors and jurisdictions in which a duty of care or similar obligations currently apply. We set out some examples below.

#### Other professional sectors

Similar duties currently exist for legal and medical professionals:

- Principle 4 of the Solicitors Regulation Authority's Principles<sup>45</sup> requires a solicitor to 'act in the best interests of each client'.
- The General Medical Council's Good Medical Practice guidance<sup>46</sup> says that doctors should 'Make the care of your patient your first concern'.

#### Financial services in other countries

- In the Netherlands, providers of financial services are subject to a duty of care requiring them to take the appropriate level of care when providing their services<sup>47</sup>.
- In the United States, the Securities and Exchange Commission (SEC) has recently proposed new rules which would affect the relationship between investment advisers and broker-dealers and their clients<sup>48</sup>. These aim to harmonise the standards applicable to investment advisers and broker-dealers and include requiring broker-dealers to act in the best interest of retail investors when making investment recommendations.

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<sup>43</sup> [www.fca.org.uk/publications/policy-statements/ps15-22-general-insurance-add-ons-market-study-%E2%80%93-remedies-banning-opt](http://www.fca.org.uk/publications/policy-statements/ps15-22-general-insurance-add-ons-market-study-%E2%80%93-remedies-banning-opt)

<sup>44</sup> [www.fca.org.uk/publication/market-studies/ms15-2-3.pdf](http://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf)

<sup>45</sup> The SRA Handbook sets out the standards and requirements applicable to solicitors. [www.sra.org.uk/solicitors/handbook/code/part2/content.page](http://www.sra.org.uk/solicitors/handbook/code/part2/content.page)

<sup>46</sup> [www.gmc-uk.org/ethical-guidance/ethical-guidance-for-doctors/good-medical-practice](http://www.gmc-uk.org/ethical-guidance/ethical-guidance-for-doctors/good-medical-practice)

<sup>47</sup> The overall duty of care provision is laid down in article 4:24a of the WFT (the Financial Supervision Act, overseen by the Dutch Authority for the Financial Markets, or AFM). Under this article, only those financial services are in scope that – broadly – advise, distribute or manufacture/offer financial products other than financial instruments (for instance insurance products and credit products). A separate duty of care article applies to MiFID-regulated activities.

<sup>48</sup> See the speech by SEC Chairman Jay Clayton on 2 May 2018, 'The Evolving Market for Retail Investment Services and Forward-Looking Regulation – Adding Clarity and Investor Protection while Ensuring Access and Choice' at [www.sec.gov/news/speech/speech-clayton-2018-05-02](http://www.sec.gov/news/speech/speech-clayton-2018-05-02).

- In Australia, a financial services licensee must 'do all things necessary to ensure that the financial services ... are provided efficiently, honestly and fairly' and have adequate arrangements for the management of conflicts of interest<sup>49</sup>. Where personal advice is provided to a retail client, the provider must act in the best interests of the client, provide appropriate advice and prioritise the client's interests over their own<sup>50</sup>.

These regulatory provisions cannot of course be read in isolation. In considering the case for enhancing our current regulatory framework with a New Duty, it is important to ensure any proposed solutions are suitable for the regime and framework we have in operation in the financial services sector in the UK.

We are keen to understand further what benefits additional duties for firms currently provide in other sectors or internationally, and whether these deliver outcomes in those regulatory regimes that the current UK regime for financial services does not.

### **Views on potential changes to our regulatory and legal framework, through a New Duty**

We have described above how our regulatory framework acts to protect consumers. We want to understand however where any 'gap' may lie which leads to consumers having inadequate protection from actual or potential harm. We also seek views on whether a New Duty could reduce complexity and bring greater clarity, or whether it could result in an additional layer of regulation and make it more complex, and, if so, how.

As well as seeking views on the merits and practicalities of introducing a New Duty, we wish to understand possible alternative approaches that might address stakeholders' concerns. We set out below some potential options for change and invite views on how these could operate in practice.

#### Rules introducing a New Duty

We could introduce a New Duty by making a rule, subject to the requirements in FSMA that apply to the exercise of our rule-making powers. We wish to understand what benefits and outcomes stakeholders believe it would achieve, over and above the existing regulatory framework set out above. Also, whether stakeholders believe there would be potential downsides.

We wish to understand how it would differ in content and effect from the existing high-level regulatory standards. Particularly, whether a new level of regulatory duty would bring greater clarity to firms' obligations or have a greater impact on their practices. We also want to understand whether it would simplify or add complexity to the current regime.

We also need to consider the consequences of introducing a New Duty. For example, whether this would be readily understood or whether it would need to be clarified

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<sup>49</sup> Sections 912A(1)(a) and (aa) of the Corporations Act 2001 (Cth)

<sup>50</sup> Part 7.7A, in particular sections 961B(1), 961G and 961J, of the Corporations Act 2001 (Cth).

through guidance or other means, and how it would sit with the current regime, in particular the Principles.

#### A statutory New Duty

Some stakeholders have called for a 'statutory duty of care'. It has been suggested that a new statutory duty would have greater status than the Principles so that it would be taken more seriously by firms and improve their culture and treatment of customers.

In considering what degree of protection is appropriate for consumers, we are already required to have regard to the principle that '... those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate ...'<sup>51</sup>. A statutory New Duty, however, would go further than this and could take a number of forms.

Legislation could require us to make rules introducing a New Duty (as has been suggested by some stakeholders). Alternatively, the New Duty could itself be set out in legislation, in which case it could potentially be supplemented by more detailed FCA rules or guidance.

We have no power to introduce a statutory New Duty; any form of statutory New Duty would require a change to primary legislation in Parliament. This is in contrast to us making a rule of our own initiative, as described above.

#### Extending the client's best interests rule

One option available to us would be to extend the scope of the 'client's best interests' rules (as described above) to cover all regulated activities.

An extension would primarily affect accepting deposits and carrying out contracts of insurance. It could only apply to regulated activities, not non-FSMA regimes or unregulated activities. It would also be subject to EU law constraints for so long as the FCA's rule-making powers remain subject to EU law, in particular the maximum harmonising effects of the Payment Services Directive 2 (PSD 2) and the Consumer Credit Directive<sup>52</sup>. This means, for example, that the effect of the rule may be limited in respect of payment services (such as execution of payment transactions) in many circumstances as such services are governed by detailed requirements in the Payment Services Regulations 2017.

For example, this could be done through an amendment to Principle 6. Arguably an obligation to 'act honestly, fairly and professionally in accordance with the best interests of its client' is a higher standard than Principle 6 which requires a firm to 'pay due regard to the interests of its customers and treat them fairly'. We are not aware, however, of

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<sup>51</sup> Section 1C(2)(e) of FSMA which says, in full, 'the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question'.

<sup>52</sup> There are other areas where we are constrained by EU law, if we wanted to effect change. For example, the Consumer Credit Directive means it is not currently possible for us to make rules requiring current account providers to give costs information at the point at which they go into an unarranged overdraft.

any judgment of a court or tribunal that has made this distinction. Alternatively (or in addition), an amendment could be made to Principle 9 to require firms to act in the best interests of its customers when providing advice or when making decisions on their behalf as it is arguably in these circumstances that the case for applying a 'best interests' obligation is strongest.

#### Additional detailed rules or guidance on a New Duty

Some stakeholders have suggested that a New Duty would be flexible and its application would depend on the complexity and risk of the product or service, perhaps being most stringent for retail investment products. To deliver the specific outcomes that stakeholders are calling for, any New Duty might need to be underpinned by more detailed rules and guidance in specific areas.

We would welcome views on whether a New Duty would require additional detailed rules and/or guidance in order to achieve the desired outcomes.

#### Additional detailed rules or guidance on the Principles

We would welcome further discussion on whether the 'treating customers fairly' and other Principles could be enhanced by new rules or guidance (which could be monitored and mitigated through supervisory or enforcement action, as appropriate) and whether that might achieve the outcomes intended by a New Duty.

For example, firms already have an obligation under the 'treating customers fairly' Principle to support consumers and treat them fairly. To clarify our expectations of firms and ensure good outcomes for consumers, particularly the vulnerable, we plan to consult early next year on guidance for firms on the identification and treatment of vulnerable consumers.

#### Conflicts of Interest

Some stakeholders have suggested that a New Duty would remove conflicts of interest. Conflicts of interest are inherent in many financial services. They can arise in a range of situations from the original design of a product to the giving of advice. At a more fundamental level, where a commercial relationship between a firm and a consumer exists, some degree of conflict of interest will be present. For example, firms have an interest in making a profit through their pricing or by increasing sales, which will be likely to conflict with the interests of their customers.

Our current regime includes a range of obligations on firms designed to deal with the problems which these conflicts can give rise to. At a high level, Principle 8 (referred to above) requires firms to manage conflicts of interest fairly, both between itself and its customers and between a customer and another client. There are also more detailed requirements such as those in the Senior Management Arrangements, Systems and Controls part of our Handbook which set out how firms should identify, manage and disclose conflicts of interest. For example, firms are required to 'maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest'<sup>53</sup>. Other rules also deal with particular

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<sup>53</sup> SYSC 10.1.7R.

types of conflicts. For example, there are detailed rules on matters such as inducements and adviser charging<sup>54</sup>. These rules prohibit certain conduct such as paying or receiving fees or commissions in particular circumstances.

We would welcome views on how a New Duty, whether a duty of care or other change, would add to the current regime and assist in mitigating or removing conflicts of interest, both across the financial services sector or with focus on particular markets.

### **Question 1**

Do you believe there is a gap in the FCA's existing regulatory framework that could be addressed by introducing a New Duty, whether through a duty of care or other change(s)?

If you believe that there is, please explain what change(s) you want to see.

We are particularly interested in your views on:

- i. The types of harm and/or misconduct any changes would address.
- ii. Whether a New Duty should be introduced and, if so, what form it should take.
- iii. What additional consumer protection and benefit this would provide, above the current regime (including over and above the existing implied term in the CRA for reasonable care and skill).
- iv. How a New Duty could and should act to mitigate or remove conflicts of interest, including the types of conflicts which exist in the provision of financial services?
- v. Whether a New Duty could reduce complexity and bring greater clarity, or whether it could result in an additional layer of regulation and make it more complex, and, if so, how?
- vi. Whether other alternatives could help address any gaps, for example, extending the clients' best interests rule to different activities.
- vii. Whether we should introduce more detailed rules and guidance, and, if so, what specific rules and guidance are required?
- viii. Whether the scope of any changes should differ between markets and whether it should include wholesale transactions.

### **Question 2**

What might a New Duty for firms in financial services do to enhance positive behaviour and conduct from firms in the financial services market, and incentivise good consumer outcomes?

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<sup>54</sup> See COBS 2.3, 2.3A, 2.3B and 6.1A.

## 3. How we regulate in practice

### Overview

Having set out the framework within which we operate, the standards that we apply to firms and the powers we have to protect consumers, we want to understand whether the way we apply these in practice does enough to prevent harm and achieve good outcomes for consumers.

Some stakeholders have said that the way we apply our rules and powers in practice is insufficient to deter firms from acting in a way that leads to negative outcomes for consumers. They explain that a New Duty could benefit consumers by encouraging firms to promote positive outcomes from the outset.

In this section, we set out how we regulate in practice. We give examples of the wide range of tools and approaches we apply across our core functions to protect consumers by preventing harm occurring in the first place, and reducing or stopping it when it does occur.

We are keen to understand whether the way we regulate results in a gap that a New Duty could address and whether a New Duty would improve our effectiveness in preventing and tackling harm and in achieving good outcomes for consumers.

### How we ensure that firms meet our standards

We set out below some of the main tools we use to protect consumers, including our authorisation, supervision, enforcement, competition and policy functions, as well as how we keep them under review.

This section illustrates how we aim to use the most appropriate tool for each type of harm, using the combination of Principles, other rules and guidance described in Section 2 above.

### Authorisation

We use authorisation to protect consumers from harm by ensuring that firms and individuals meet minimum standards. For firms that wish to be authorised under FSMA these are referred to as the Threshold Conditions<sup>55</sup>. If a firm wishes to appoint individuals into certain key roles they must meet a separate set of minimum standards known as the Fit and Proper Test.

Firms and individuals must demonstrate to us that they meet the minimum standards and will continue to meet them for as long as they are authorised.

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<sup>55</sup> Equivalent standards apply for firms seeking authorisation under other regulations, such as the Payment Services or Electronic Money Regulations.

- We look at a wide range of factors, including the way the firm is organised, its business strategy and model and the integrity, financial soundness and competence of individuals
- Individuals must demonstrate honesty and integrity, they must be financially sound, and they must have the necessary competence and capability to carry out the role

Authorisation and supervision are key tools we use to improve conduct and culture in firms. We do this by testing the most significant drivers of behaviour that can create cultures which lead to harm. We look at a number of factors, including the firm's purpose, attitude, behaviour, its approach to managing and rewarding people and the firm's governance arrangements, controls and key processes (for example, for whistleblowing or complaint handling).

We will refuse to authorise a firm if it does not satisfy us that it meets and will continue to meet the minimum standards.

### **Improving the quality of debt management advice**

Following our 2015 thematic review on the Quality of debt management advice<sup>56</sup>, we assessed the risk of harm posed by many firms as high, particularly as many of their customers were vulnerable. We refused to authorise those firms which would not satisfy, and continue to satisfy, our Threshold Conditions; others chose to leave the market.

Our Approach to Authorisation provides more detail on how we authorise firms.<sup>57</sup>

### **Supervision**

Once firms are authorised, our supervisory function protects consumers by maintaining continuous oversight of regulated firms and individuals to identify, reduce or prevent harm to consumers and markets.

We apply our judgment using the framework of the Principles and other rules as described in Section 2 above, which represent minimum standards of conduct. We have developed key supervisory principles which guide our work and help us prioritise our interventions to deliver our objectives; these are complementary to the Principles for Businesses.

Our approach includes pre-emptive identification of harm and quick and efficient action to address the root causes of harm when it is occurring. We use data, intelligence and analytical tools to build a picture of perceived harms. This drives our proactive, preventative supervisory activities.

<sup>56</sup> TR15/8: Quality of debt management advice, FCA, 2015.

<sup>57</sup> [www.fca.org.uk/publication/corporate/our-approach-authorisation.pdf](http://www.fca.org.uk/publication/corporate/our-approach-authorisation.pdf)

Where our supervision function identifies issues that require wider solutions (say, across a whole market through rule changes) or more intensive investigation and remedial action, we may then use other regulatory tools such as policy development or opening an enforcement investigation.

### **Fair treatment of interest-only mortgage customers**

Following our 2013 thematic review of the Fair treatment of existing interest-only mortgage customers, we issued guidance setting out our views on how firms could act in accordance with our treating customers fairly Principle to achieve a fair outcome for their customers who risk being unable to repay their loan<sup>58</sup>.

We recently conducted further work to see what changes had been made since we published our guidance<sup>59</sup>. We found that all the lenders in our sample have made progress in the fair treatment of these customers and that engagement between lender and customer earlier in the mortgage term may achieve fairer outcomes.

Assessing the drivers of culture is central to our pre-emptive identification of harm. This allows us to anticipate potential problems in firms and markets. We explained in Section 2 above how the SM&CR now acts as a key tool in our framework to improve the drivers of culture in authorised firms and raise the standard of conduct of individuals.

Alongside this, we use the CRA as part of our supervisory work. Where we identify unfair terms, we have the power to apply for an order from the court to prevent a firm relying on the term or to accept an undertaking given to us by a firm in lieu of seeking an order. In 2017, we published 2 undertakings under the CRA, from London General<sup>60</sup> and PPRO<sup>61</sup>.

Our Approach to Supervision provides more detail on how we supervise firms.<sup>62</sup>

### **Enforcement**

Our enforcement function protects consumers by making it clear there are real and meaningful consequences for firms and individuals who do not follow the rules. We use a wide range of enforcement powers – criminal, civil and regulatory – to protect consumers and to take action against firms and individuals that do not meet our standards. This includes, where possible, seeking redress or remedy for those harmed.

Through publication of enforcement outcomes, we also act transparently to raise awareness of regulatory standards more widely, so others can use this to improve their own conduct.

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<sup>58</sup> FG13/7 - Dealing fairly with interest-only mortgage customers who risk being unable to repay their loan, FCA, 2013.

<sup>59</sup> [The fair treatment of existing interest-only mortgage customers \(TR18/1\)](#), FCA Thematic Review, January 2018.

<sup>60</sup> Notice of Undertaking: London General Insurance Company Limited, FCA 2017.

<sup>61</sup> Notice of Undertaking: PPRO Financial Limited, FCA 2017.

<sup>62</sup> Our Approach to Supervision [www.fca.org.uk/publication/corporate/our-approach-supervision.pdf](http://www.fca.org.uk/publication/corporate/our-approach-supervision.pdf)

To prevent harm, our enforcement division works closely with our authorisation, supervision, and strategy and competition divisions, as well as other regulators and law enforcement. This means we can identify and act early when enforcement action is necessary.

To prevent harm, we can open an enforcement investigation against firms for breach of the Principles. These can be used as the sole basis for enforcement action and include cases where we have taken action for failing to treat customers fairly, in breach of Principle 6.

### **Enforcement of the Principles including treating customers fairly**

In February 2018, we imposed a fine of £1,976,000 on Vanquis Bank for breaches of Principles 6 (treating customers fairly) and 7 (Communications with customers) of our Principles for Businesses, after the firm failed to disclose the full price of an add-on product to its credit cards.<sup>63</sup>

Alongside this, we - including our Unregulated Business Department (UBD) - prevent harm to consumers through education and awareness campaigns such as our ScamSmart campaign to help consumers avoid investment and pension scams<sup>64</sup>.

Our Approach to Enforcement<sup>65</sup> and Enforcement Guide ('EG')<sup>66</sup> provide more information on our enforcement activities.

### **Competition**

We use our competition powers to protect consumers by ensuring markets work well. We are one of the few financial regulators with a core objective to promote competition. Effective competition in financial services benefits consumers and the economy.

Our work across wholesale and retail markets aims to keep markets open to entry and innovation. We tackle anti-competitive conduct and intervene to ensure competitive forces drive good outcomes for consumers. Part of our work is about supporting consumer choice, including moving from an unsatisfactory supplier to a better one. We give particular attention to areas where customers' and firms' interests are not well aligned.

As discussed in Section 2, we may undertake an investigation under the CA98 and equivalent EU provisions and, following that, take action to fine individual firms who have breached the law. Or we may conduct a market study which is an in-depth, evidence-driven investigation that can propose solutions. We typically undertake a market study where we believe that the drivers of harm might go further than firm conduct and may arise from how the market itself functions. The primary aim is to

<sup>63</sup> See our [Final Notice](#) of 27 February 2018.

<sup>64</sup> [www.fca.org.uk/scamsmart](http://www.fca.org.uk/scamsmart)

<sup>65</sup> [www.fca.org.uk/publications/corporate-documents/our-approach-enforcement](http://www.fca.org.uk/publications/corporate-documents/our-approach-enforcement)

<sup>66</sup> See the [EG pages](#) in the FCA's Handbook on our website.

identify if and/or how a market could be made to work better, rather than focusing on past firm conduct and firms' adherence to our rules. The remedies that flow from market studies can go beyond applying current rules to putting in place remedies that seek to change firm or consumer behaviour and as a result, achieve better consumer outcomes.

### **Encouraging fair treatment of customers**

In our Mortgage Market Study Interim Report<sup>67</sup>, we encourage firms to consider the fair treatment of consumers who stay on relatively expensive reversion rates (the interest rate payable once an introductory rate ends) for an extended period. Such customers who cannot switch are sometimes referred to as 'mortgage prisoners'.

In insurance, following the publication of our Market Study on general insurance add-ons<sup>68</sup>, we are piloting the publication of value measures data. This includes claims frequencies and average claims pay-out by insurer. It seeks to help consumers make informed decisions about insurance needs, improve transparency and act as a reputational incentive on firms<sup>69</sup>.

Our Approach to Competition provides more information on our competition activities.<sup>70</sup>

## **Policy**

We protect consumers by putting in place the necessary rules and guidance. We use our powers to maintain and implement a framework of rules and guidance that reduces harm and makes markets work better.

We make policy interventions to protect consumers from practices that cause actual harm or carry a high risk of harm. This can include rule changes, publishing Guidance, or communications with firms or customers such as sending 'Dear CEO' letters<sup>71</sup> or issuing customer warnings about particular products.

### **Protecting consumers from unfair practices in insurance**

As an example of rule changes, following our 2015 Market Study on General Insurance add-ons, we made new rules which banned opt-out selling and improved the information to customers buying add-ons.

We also found consumers were significantly overpaying for Guaranteed Asset Protection (GAP) insurance sold alongside motor vehicles. Motor dealers had a strong point of sale advantage and consumers were unaware of lower priced products elsewhere. To improve consumer outcomes and help consumers make more considered purchasing decisions, we introduced rules requiring a deferral between the introduction and sale of the GAP

<sup>67</sup> Mortgages Market Study Interim Report, Market Study, MS16/2.2, May 2018.

<sup>68</sup> General Insurance Add-Ons: Final Report – Confirmed Findings of the Market Study, July 2014.

<sup>69</sup> [General Insurance value measures pilot](#), FCA website as updated on 2 March 2018.

<sup>70</sup> [www.fca.org.uk/publication/corporate/our-approach-competition.pdf](http://www.fca.org.uk/publication/corporate/our-approach-competition.pdf)

<sup>71</sup> A 'Dear CEO' letter is a letter addressed to CEOs of firms outlining our particular concerns about the market or industry they operate in.

product. We also introduced mandatory information disclosure by add-on sellers to consumers.

While work evaluating the impact of our GAP intervention is ongoing, current evidence suggests that add-on GAP sales are much lower than they would have been had we not intervened.

Policy changes have helped bolster work by our other core functions described above, such as supervision and enforcement. They have worked closely together to challenge firms' business models to tackle existing harm and where we believe there to be a risk of future harm.

### **Tackling harm in consumer credit**

Across the FCA, we have already taken significant action where consumer credit firms fail to meet our standards, using the authorisation process, supervision and, where appropriate, enforcement. Firms have made substantial improvements, particularly in their creditworthiness assessments and dealing with consumers in financial difficulty. By February 2018, we had also secured £901 million redress (write downs and payments) for over 1.7 million consumer credit customers. We also have an important role in promoting competition and innovation, and in working with others to influence demand in credit markets.

### **Looking to the future**

In this section, we have explained the way we regulate in practice, using our full suite of powers and tools to prevent harm to consumers.

We have set out how we use authorisation and supervision to ensure that we maintain continuous oversight of regulated firms and that they meet common sets of entry requirements at the start. We have also explained how we use our enforcement function to achieve fair and just outcomes in response to misconduct, while ensuring competition is working effectively for consumers in the markets we regulate. We have also explained how we can modify rules where necessary and make policy interventions to protect consumers from practices that carry a high risk of harm.

We seek to be a pro-active regulator by identifying and reducing harm for consumers before it occurs and dealing with harm when it occurs to achieve fair outcomes. Through our examples, we have shown how we apply our Principles, rules and guidance in practice, looking at markets thematically and in market studies to help lay the basis for wider change.

Having set out some practical examples of the way in which we act to protect consumers, we want to understand what a New Duty might add to the way in which we operate.

### **Question 3**

How would a New Duty increase our effectiveness in preventing and tackling harm and achieving good outcomes for consumers? Do you believe that the way we regulate results in a gap that a New Duty would address?

## 4. Consumer outcomes, including redress

Having discussed the way we regulate in practice, we want to understand whether a New Duty would be more effective in preventing harm occurring in the first place for consumers. We also want to understand whether complaint mechanisms and redress would need to be relied on less.

In this section, we explain the various routes by which consumers can currently obtain redress (that is, the payment of money or other action by a firm to remedy harm done). We also consider whether a New Duty would provide an additional route by which consumers could secure redress, and whether that is needed.

Routes to redress provide an important source of market confidence and integrity. Consumers are likely to be more willing to engage with financial services if they are confident that they can challenge unfair treatment and obtain a remedy. This can help deter firms from treating consumers unfairly in the first place.

The best consumer outcome is to prevent harm from occurring in the first place. However, in financial markets, as with any other market, sometimes things go wrong and a customer feels that a promise has not been kept or they have been unfairly treated. In such cases, suitable routes to redress are necessary to provide a good outcome for affected consumers.

The principal, current mechanisms for a consumer to obtain redress are:

- Making a complaint to the firm and, if it is not satisfactorily resolved, referring that complaint to the Financial Ombudsman Service.
- Taking action against the firm in court.
- As a result of action taken by the FCA.

### Complaints

Effective, accessible and trusted internal complaints systems operated by firms themselves are of fundamental importance to treating consumers fairly<sup>72</sup>. They remove the need for consumers, firms and regulators to use large amounts of resource on more formal and binding redress mechanisms. Where firms identify recurring or systemic problems, they are required to identify their root causes and correct them, and consider what actions may be needed for customers who have not complained<sup>73</sup>. A New Duty would be relevant to how firms assess complaints.

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<sup>72</sup> We set the rules for how firms must handle complaints, see DISP 1.

<sup>73</sup> Dispute Resolution part of the Handbook DISP 1.3.3R and DISP 1.3.6G.

## The Financial Ombudsman Service

If a consumer makes a complaint through a firm's internal complaints process and they are unhappy with the firm's final response<sup>74</sup> the consumer can bring a complaint to the Financial Ombudsman Service for consideration.

The scheme is designed to resolve disputes independently, quickly and with minimum formality at no charge to consumers. The FCA determines which disputes the ombudsman can deal with<sup>75</sup>. The ombudsman can make an award (currently a maximum of £150,000<sup>76</sup>) or a direction, both of which are enforceable in court<sup>77</sup>.

Complaints are determined by reference to 'what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case'<sup>78</sup>. The ombudsman takes into account relevant law and regulations, regulators' rules, guidance and standards, codes of practice and (where appropriate) what is considered to have been good industry practice at the time.<sup>79</sup> The ombudsman is therefore not bound to resolve the dispute in accordance with the law. The ombudsman would need to take into account a New Duty in the same way as the existing regulatory framework.

The 'fair and reasonable' test applied by the ombudsman is, like the Principles, drafted at a high-level and both refer to the concept of fairness. To that extent, we consider that the tests involve the FCA and the ombudsman applying very similar considerations to the issues in front of them. The ombudsman's test, however, necessarily takes into account the specifics of particular cases, recognising its role in resolving individual complaints. This differs from the FCA's role in setting, supervising and enforcing standards for firms generally.

The FCA and the Financial Ombudsman Service co-operate with each other in the exercise of their respective functions<sup>80</sup>. This is particularly important where the FCA is taking supervisory or regulatory action and, at the same time, the Financial Ombudsman Service is receiving a significant number of cases concerning the same issue. Outcomes for consumers as a result of FCA action and ombudsman decisions will generally be broadly similar. However, this will not always be the case. This is because the Financial Ombudsman Service is operationally independent from the FCA, and makes individual decisions which are fair and reasonable in all the circumstances of a particular case.

## Court Action

Consumers can also take action against a firm in court in certain circumstances, although this can be very costly. Actions include breach of contract, tort (for example, misrepresentation) or an action to enforce the implied contractual duty of care under the

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<sup>74</sup> Firms are required to issue within 8 weeks – less for payment services complaints

<sup>75</sup> The Ombudsman can also settle some other disputes as agreed with firms. See DISP 2.3 and 2.5 for more information.

<sup>76</sup> We are considering increasing this, see CP18/3 paragraphs 4.14-4.33.

<sup>77</sup> DISP 3.7.13G.

<sup>78</sup> See section 228(2) of FSMA and DISP 3.6.1R.

<sup>79</sup> DISP 3.6.4R.

<sup>80</sup> See the Memorandum of Understanding between the FCA and the Financial Ombudsman Service dated 18 December 2015 for further details.

CRA<sup>81</sup>. Where a term or notice is unfair under the CRA, a consumer could rely on the fact that it is not binding on them in any court action against a firm. We are keen to understand what additional consumer benefit a New Duty would provide if it were to give consumers an actionable claim.

In addition, FSMA allows<sup>82</sup> us to determine, for each of our rules, whether certain people who are 'private persons'<sup>83</sup> have a right of action for damages in the case of loss caused by a breach of that rule (subject to some limited exceptions). As the definition of 'private person' is set out in a regulation made under FSMA, any extension would be a matter for the Treasury and Parliament, not the FCA. For a breach of the Principles, we do not allow consumers such a right of action against a firm,<sup>84</sup> nor can we impose a consumer redress scheme for such a breach (see below).

In contrast, the ability of a 'private person' to take action for a breach of the 'best interests' rules, discussed in Section 2, has been retained. Where such a rule applies, consumers would generally be able to take action in court if they suffered a loss as a result of a breach of such a rule by a firm.

We would need to consider whether breach of any New Duty should give rise to a right of action for damages in court. The rationale for not allowing rights of action in relation to the Principles was set out in the FSA's original consultation paper on the Principles in 1998<sup>85</sup>.

In summary, the rationale is that the risk of civil litigation driving the interpretation and application of the Principles outweighs the benefit to consumers of being able to take action against firms, given that consumers can take action in respect of other, more specific rules. Nevertheless, it is open to the FCA to re-visit this issue and consider again what the potential benefit and detriment would be of making breaches of the Principles actionable by private persons.

In practice, the number of decided court actions based on a breach of FCA rules where the right of action already exists has been relatively small. We believe that this reflects a relatively small number of court cases initiated.<sup>86</sup> The FCA has a right to make representations to the court in such cases on the meaning of our rules<sup>87</sup> and we have exercised this right in some cases.

The Law Commission consulted on extending rights of action for breaches of FCA rules in 2014<sup>88</sup>. This was both for expanding the ability of businesses to sue and to enable actions on the basis of breaches of the Principles. The Law Commission did not feel able

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<sup>81</sup> Opt-out class actions cannot currently be brought in the UK except for breach of competition law.

<sup>82</sup> Section 138D of FSMA.

<sup>83</sup> Broadly, under the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 this includes individuals but excludes businesses.

<sup>84</sup> PRIN 3.4.4R.

<sup>85</sup> Para. 23 of the FSA's CP13 entitled 'The FSA Principles for Businesses', October 1998 ([www.fsa.gov.uk/library/policy/cp/1998/13.shtml](http://www.fsa.gov.uk/library/policy/cp/1998/13.shtml)).

<sup>86</sup> We should be aware of the number of court cases, as firms are required to notify us of any action brought against them for breach of the rules, although in our experience they do not always do so. SUP 15.3.15R(2).

<sup>87</sup> [Practice Direction 8A paragraph 21.4 of the Civil Procedure Rules 1998](#).

<sup>88</sup> [Fiduciary Duties of Investment Intermediaries](#) (Law Com No 350, 30 June 2014), paragraphs 11.10 to 11.35.

to recommend such a change at that stage. On balance, it concluded that the effects of the change are uncertain and that:

- It could be disruptive and add to costs, while encouraging defensive rather than beneficial behaviour.
- It is also extremely controversial, with most financial intermediaries opposed to the change.
- On the other hand, providing a right to sue for a failure to treat customers fairly would underline the importance that all participants in financial markets 'should act in the best long-term interests of their clients or beneficiaries'.
- It is possible that a limited extension, subject to suitable defences, could be implemented without undue costs.

### **Our role in providing redress**

It has been argued that we over rely on redress schemes after the event, rather than doing enough to prevent harm and that a New Duty would help prevention. In this section, we set out the various routes by which consumers can currently obtain redress.

We have a number of ways of providing redress to consumers:

- Making rules and guidance on how particular types of complaints should be dealt with by firms (for example, PPI).
- Specific statutory powers exercisable against an individual firm, such as under the CRA relating to unfair terms, and FSMA powers to order restitution.
- A power to order an industry-wide consumer redress scheme, where there has been widespread or regular failure by firms.
- Voluntary schemes which can apply to regulated or unregulated activities of firms, and may be industry-wide or specific to an individual firm (and might include a scheme of arrangement under the Companies Act 2006).

The power to order an industry-wide consumer redress scheme is only available in specific circumstances. That is where it appears that there may have been widespread or regular failure by firms to comply with applicable requirements and where it appears that, as a result, consumers have, or may, suffer loss or damage that, if they brought legal proceedings, a remedy or relief would be available<sup>89</sup>. Such a scheme is not available for a breach of the Principles as consumers cannot obtain a remedy in court in this situation.

We will generally consider exercising our redress powers where there has been widespread or regular failure by an individual firm or group of firms to comply with requirements. Our actions will depend on the particular circumstances and a consideration of how best to advance our objectives having regard to relevant principles. This includes that the burden of the redress scheme should be proportionate to the benefits.

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<sup>89</sup> See section 404 of FSMA.

We agree that prevention is better than redress. But we nevertheless believe that the use of our redress powers is important both as a deterrent and to provide redress where problems occur in the financial services market.

We seek views on whether breaching the Principles, or a New Duty, should be actionable by consumers. We also want to understand whether, and if so how, a New Duty would mean that consumers would need to rely less on redress.

#### **Question 4**

Should the FCA reconsider whether breaches of the Principles should give rise to a private right for damages in court? Or should breaching a New Duty give this right?

#### **Question 5**

Do you believe that a New Duty would be more effective in preventing harm and would therefore mean that redress would need to be relied on less?

If so, please set out the ways in which a New Duty would improve the current regime.

## 5. Questions

### Questions – our call for views

We want to understand the reasons for introducing any New Duty: whether there is a gap in our legal and regulatory framework, and whether this relates to its scope, the way we apply it in practice, or both.

We ask below specific questions to support our thinking on this topic. We seek specific examples and evidence to support your answers wherever possible.

### Section 2: Our regulatory and legal framework

#### Question 1

Do you believe there is a gap in the FCA's existing regulatory framework that could be addressed by introducing a New Duty, whether through a duty of care or other change(s)?

If you believe that there is, please explain what change(s) you want to see.

We are particularly interested in your views on:

- i. The types of harm and/or misconduct any changes would address.
- ii. Whether a New Duty should be introduced and, if so, what form it should take.
- iii. What additional consumer protection and benefit this would provide, above the current regime (including over and above the existing implied term in the CRA for reasonable care and skill).
- iv. How a New Duty could and should act to mitigate or remove conflicts of interest, including the types of conflicts which exist in the provision of financial services?
- v. Whether a New Duty could reduce complexity and bring greater clarity, or whether it could result in an additional layer of regulation and make it more complex, and, if so, how?
- vi. Whether other alternatives could help address any gaps, for example, extending the clients' best interests rule to different activities.
- vii. Whether we should introduce more detailed rules and guidance, and, if so, what specific rules and guidance are required?
- viii. Whether the scope of any changes should differ between markets and whether it should include wholesale transactions.

#### Question 2

What might a New Duty for firms in financial services do to enhance positive behaviour and conduct from firms in the financial services market, and incentivise good consumer outcomes?

### **Section 3: How we regulate**

#### **Question 3**

How would a New Duty increase our effectiveness in preventing and tackling harm and achieving good outcomes for consumers? Do you believe that the way we regulate results in a gap that a New Duty would address?

### **Section 4: Consumer outcomes, including redress**

#### **Question 4**

Should the FCA reconsider whether breaches of the Principles should give rise to a private right for damages in court? Or should breaching a New Duty give this right?

#### **Question 5**

Do you believe that a New Duty would be more effective in preventing harm and would therefore mean that redress would need to be relied on less?

If so, please set out the ways in which a New Duty would improve the current regime.

#### **How to respond**

We are asking for responses to these questions and comments on the paper by 2 November 2018.

You can send them to us using the form on our website at: [www.fca.org.uk/dp18-05-response-form](http://www.fca.org.uk/dp18-05-response-form)

Or in writing to: Consumer Insight, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN

Or by e-mail to: [dutyofcare@fca.org.uk](mailto:dutyofcare@fca.org.uk)

## **ANNEX 1 – THE CONCEPTS OF DUTY OF CARE AND FIDUCIARY DUTY**

### **Duty of care**

'Duty of care' refers, broadly, to a legal obligation to take care which, when breached, will make the person at fault liable to compensate the victim for the loss they have suffered.

A duty of care can arise in a range of circumstances, including:

- in a tort, such as negligence, where there is a duty to take reasonable care
- in contract, where such a duty may be express or implied (and may take the form of reasonable care or could be a different standard)
- the duty owed by a trustee to a beneficiary
- as a result of statute, for example, section 49 of the CRA (discussed above) and section 1 of the Trustee Act 2000

To recover a loss it is also necessary to show, depending on the nature of the duty (for example, tort or contract), other matters such that the duty was breached, that the breach caused the loss and that the loss was foreseeable and not too remote.

So, a 'duty of care' is a positive obligation on a person to ensure that their conduct meets a set standard. In the context of firms dealing with consumers, this normally means an obligation to exercise reasonable care and skill when providing a product or service.

### **Fiduciary duty**

The concept of a 'fiduciary duty' is one that the courts have developed over time. It is complex and challenging to define. The key questions are when somebody will be a fiduciary and, when they are, what duties will they owe?

#### **Who is a fiduciary?**

There are certain categories of relationship which have been established by the courts as giving rise to a fiduciary relationship. For example, fiduciary duties are owed by trustees to beneficiaries and by solicitors (and other advisers) to their clients.

The court will look at the substance of a relationship to determine whether a fiduciary duty exists. While the case law is not clear on precisely how this will be done it appears to turn largely on whether there is a legitimate expectation that one party (the fiduciary) will act in another's interest. Factors that are likely to be relevant include whether the fiduciary exercises discretion, has the power to act on behalf of the other party and the vulnerability of that other party<sup>90</sup>.

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<sup>90</sup> [Fiduciary Duties of Investment Intermediaries](#) (Law Com No 350, 30 June 2014), paragraphs 3.23-3.24.

## What duties does a fiduciary owe?

These are also somewhat uncertain and will vary depending on the type of relationship. However, in general, a fiduciary<sup>91</sup>:

- must act in good faith
- must not make a profit out of his trust (other than with the consent of the client)
- must avoid conflicts of interest (either between its own interests and those of the client or between the interests of different clients)

A fiduciary may, of course, owe other duties to a client as a result of an agreement (either express or implied terms), in tort (for example, misrepresentation) or as a result of regulation (for example, primary legislation or the FCA Handbook). Fiduciary duties may generally be altered or restricted by agreement between the parties.

It has been said that fiduciary duties are about what a fiduciary cannot do, rather than imposing a positive duty to act (although many fiduciaries may separately be under such duties).<sup>92</sup>

### Comparison of the duties

A duty of care and a fiduciary duty, therefore, have somewhat different purposes. A duty of care is a positive obligation that aims to ensure that people are not reckless or incompetent whereas a fiduciary duty is largely a prohibition on acting in a way that is somehow disloyal or improper.<sup>93</sup>

This picture is complicated by the fact that in many, if not most, cases, a person who has fiduciary duties is also subject to a duty of care. Fiduciaries duties apply in much more limited circumstances than a duty of care. This makes it tempting to think of a fiduciary duty as being a stricter standard than a duty of care.

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<sup>91</sup> Bristol & West Building Society v Mothew [1998] Ch 1 at 18

<sup>92</sup> [Fiduciary Duties of Investment Intermediaries](#) (Law Com No 350, 30 June 2014), paragraphs 3.41-3.42.

<sup>93</sup> See, for example, *Fiduciary Duties of Investment Intermediaries*, A Consultation Paper (Law Com CP No 215, 22 October 2013) at paragraph 6.34.

## **ANNEX 2 - OUR CUSTOMER OUTCOMES FOR TREATING CUSTOMERS FAIRLY**

There are 6 consumer outcomes that firms should strive to achieve to ensure fair treatment of customers. These remain core to what we expect of firms<sup>94</sup>:

1. Outcome 1: Consumers can be confident they are dealing with firms where the fair treatment of customers is central to the corporate culture.
2. Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
3. Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
4. Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances.
5. Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.
6. Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

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<sup>94</sup> [www.fca.org.uk/firms/fair-treatment-customers](http://www.fca.org.uk/firms/fair-treatment-customers)