Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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A duty of care for financial services providers

A legislative proposal for a duty of care

The Financial Services Consumer Panel proposes that the Financial Services & Markets Act (FSMA) should be amended to require the Financial Conduct Authority (FCA) to make rules specifying what constitutes a 'reasonable' duty of care that financial services providers should owe towards their customers.

We are not proposing a fiduciary duty, but a duty of care that would oblige providers of financial services to avoid conflicts of interest and act in the best interests of their customers. A similar duty already exists for other sectors, for example, for legal and medical professionals through the Solicitors Regulation Authority's Principles[1] or the General Medical Council's Good Medical Practice Guide[2].

Whilst a duty of care of the type we propose would ultimately give consumers a legal right to take financial services providers to court, this is not the Panel's reason for suggesting it. The primary purpose of the duty of care would be to operate as a preventative measure, in particular by removing conflicts of interest. We would expect disputes to continue to be settled by the Financial Ombudsman Service (FOS) - recourse to the courts, bearing in mind its prohibitive cost, would only be a last resort.

Why we need a duty of care

The FSMA principle that firms should "treat customers fairly" (TCF) does not remove conflicts of interest and so does practically nothing to deter firms from mis-selling products and services. Once these practices are identified after the event consumers have to fight a long and stressful battle through the FOS to get compensation. Those outside the FOS's jurisdiction (eg small businesses) are often reliant on mass redress schemes that are imposed on them without proper consultation. This is costly and burdensome for them, and, for many, does not feel fair. Putting things right 'after the event' further diminishes trust in the financial services sector.

TCF only enshrines a weak duty to the consumer, further weakened by the legal principle in FSMA that consumers should 'take responsibility for their decisions'. The 'consumer responsibility' principle fails to take into account the imbalance in power between firms and their customers and information asymmetries. The Panel believes consumers can only reasonably be expected to take responsibility for their decisions where firms have exercised a duty of care.

A duty of care would rebalance the information and bargaining position asymmetries between firms and consumers and would operate to prevent poor conduct. Properly applied a duty of care might even eventually provide scope for a reduction in the amount of detailed rules.

How would it work?

The Panel's proposed amendment of FSMA would require the FCA to make rules on a duty of care, but the exact scope would be for the FCA to decide, subject to its normal consultation procedures. The Panel envisages that the rules would be flexible, and depend on the complexity and the risk of the product being sold. The more complex or risky the product, the more stringent the duty would be on the provider to ensure the product was suitable and that the customer understood what they were buying, and the risks involved.

The proposed duty would not affect the broad definition of 'consumer' in FSMA, so would apply to both wholesale and retail business. However, the primary intention would be to protect retail and smaller business customers. Accordingly, the Panel envisages that the FCA's rules would be most stringent for, for example, investment products offered to retail consumers, or complex hedging products aimed at small businesses.

What difference would it make?

A duty of care would engender long-term cultural change in financial services providers. It would bring much-needed clarity to the rules governing the relationship between firms and their customers. Properly supervised and enforced, an obligation for banks and other financial institutions to act in their customers' best interest would help prevent mis-selling and other poor behaviour towards customers from occurring in the first place.

Firms would no longer be able to adopt a "let's see if we can get away with it" approach, but would have to avoid conflicts of interest and take their customers' best interests into account at every stage of their engagement.

In short, a duty of care would effectively deliver what TCF is intended, but so clearly fails, to do.

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1 http://www.sra.org.uk/solicitors/handbook/code/part2/content.page.
2 http://www.gmc-uk.org/guidance/good_medical_practice/duties_of_a_doctor.asp

Annex

Financial Services Consumer Panel examples of TCF failures where firms have not broken FCA rules

The principles for businesses include the following:

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.

Principle 9: Conflicts of interest - A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

The examples we have clearly demonstrate that the principles for business do not protect consumers adequately.

Governance

- TCF has failed to address the inherent conflicts of interests in large global firms (and for the individual executives within them) which receive multiple levels of fees from the same pension and insurance asset pools through multiple subsidiaries and complex business arrangements.
- TCF has failed to generate a consumer focus in Board rooms where business models and strategy continue to be developed without regard to whether the models create value for money for the end user. We still see examples of fund managers and bankers being paid large salaries and bonuses for achieving short-term goals which are inconsistent with the long-term retirement and savings goals of consumers who contribute many years of hard earned money to the asset pools. This is not fair.
- Banks continue to promote and reward staff on the basis of sales made to customers. PPI is the most egregious example of this; TCF makes no difference.

Savings

- Banks can reduce interest rates on existing customers' accounts by declaring an account "obsolete". TCF only requires banks to tell customers about changes to the interest rates on their account range. Equally, new rules on disclosure of interest rates are not being applied to "obsolete" accounts (which are of course not obsolete from the customer's perspective). The FCA's 2013 market study[3] showed that for easy access products, interest rates were on average 0.82 percentage points higher in accounts opened within the last two years than accounts opened more than five years ago. Under a duty of care, banks should ensure that customers of "obsolete" accounts were migrated to accounts offering at least as good value, without the requirement to open a new account.

Investments

- Banks are launching 'robo-advice' services which meet FCA rules as the service is execution only. However, they fall short of the principles for business as they fail to make costs and charges clear. Panel research in this area[4] demonstrated how several firms promoted 'all-in' fees that did not include additional costs borne by the consumer. A duty of care would mean firms would have to disclose costs and charges in a prominent, clear and easy to understand way.

Retail banking

- If a customer tries to withdraw funds beyond their overdraft limit, banks can allow the withdrawal without telling the customer at the point of making the decision what charges will result. Under TCF, as long as the customer has been told the charging structure, this is considered fair.
- If suspicious activity, or other reasons of de-risking, means a bank chooses to close a consumer's account, they are very slow to clear the customer and allow them access to their funds, or take further action. Customers are meanwhile in limbo, and cannot utilise their account, or access their money. 2016 research from the FCA on de-risking says that FOS reported a current case load of 20-30 complaints about account closures per week.[5]

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[3] https://www.fca.org.uk/publication/market-studies/cash-savings-market-study-final-findings.pdf
[4] https://www.fs-cp.org.uk/sites/default/files/final_panel_position_paper_online_investment_and_advice_services.pdf
[5] https://www.fca.org.uk/publication/research/drivers-impacts-of-derisking.pdf

- Consumers are left languishing in old Basic Bank Accounts, often on less favourable terms and potentially facing fees or charges on their account. TCF does not ensure banks move their customers onto the new non-fee charging Basic Bank Accounts.

Consumer Credit

- The recent FCA thematic review into early arrears management in unsecured lending shows that firms are still missing early opportunities to identify customers in financial difficulty and offer appropriate forbearance. Moreover, the findings showed that a firm's culture influences the approach taken to giving due consideration and forbearance to customers in arrears difficulties.
- Credit card companies frequently offer inappropriate products with unaffordable credit limits to consumers, and fees and charges are not always transparent and proportionate. TCF has no impact on this behaviour.
- Lenders entice borrowers with low-interest headline rates but actually lend at rates twice as high. A duty of care would ensure firms did not advertise rates a large majority of consumers were unlikely to get.

Savings and Long-term investments

- Insurance companies operating with-profits funds are able to use the money held in these funds for purposes which benefit shareholders such as paying mis-selling costs, funding a deficit in the insurance company's staff pension scheme, subsidising new business and paying shareholders' tax bills on their share of profits from the fund.
- Investment management firms launch better value fund share classes with lower charges but leave loyal customers in older more expensive share classes and do not inform them that cheaper share classes are available.
- P2P lending platforms are advertising excessively optimistic potential returns and making unjustified claims about safety and security.

General Insurance

- Customers who have been with their home insurance provider for 5 years pay 70% higher premiums than new customers despite evidence suggesting that they pose no higher risk than new customers.[6]
- Insurance firms should offer their best price automatically to existing customers. That they don't, suggests they are exploiting the inertia of loyal customers who so not shop around, or who trust their provider to treat them fairly.

Mortgages

- Mortgage firms keep captive customers on higher SVRs and fail to offer them the ability to move to cheaper fixed rates.
- Advisers are not required to take consumers' debts or benefit entitlements into account when advising on equity release products. A duty of care would ensure the advice offered to consumers took account of consumers' full circumstances when recommending the best product for their needs, in particular whether there were cheaper ways of paying off debts.
- Providers must ensure equity release is suitable for consumers when the product is taken out, but are not required to carry out additional checks when consumers draw down funds from a reserve facility, which can be many times larger than the original loan. A duty of care would ensure providers checked suitability at all stages of further lending.

[6] FCA (2015), Occasional Paper 12, Encouraging consumers to act at renewal Evidence from field trials in the home and motor insurance markets