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

4 August 2021

Dear Sir/Madam,

PRACTITIONER PANEL RESPONSE TO CP21/13 – A NEW CONSUMER DUTY

The Panel feels strongly about the need to ensure good consumer outcomes and welcomes the FCA's desire to focus the sector on consumers and improving their experience of financial services. In our view, this work is one of the most important initiatives to be undertaken by the FCA, to formulate regulation which will underpin the activity of the entire financial services industry for years to come. It is also being undertaken at a challenging pace, to meet the targets of the Financial Services Act 2021.

Identifying the problem

In order to inform our response we have commissioned Frontier Economics to estimate the economic impact of the FCA's proposals and to look at the potential consequences, both intended and unintended, of the different proposals. The research was carried out by interviewing a number of very senior people, in the industry and the regulator. It has concluded that robust quantification of the impact of the proposals is not possible at this stage, given there is no agreed evidence base for the status quo against which to measure the changes driven by the proposals, the proposals themselves remain vague at this early point in the overall consultation process, and that they are limited to changes in one or two of a wider set of regulatory forces that will determine the outcomes.

The Practitioner Panel is supportive of regulatory development which reiterates firms' responsibilities towards their customers and reinforces good practice within the industry. Given the evidence in the consultation we accept the need for a higher standard than that of the existing Principle of Treating Customers Fairly. We believe, however, that some of the proposals in this consultation will create increased regulatory risk, resulting in a series of additional compliance costs on firms, and that the expected behavioural responses risk imposing an additional set of costs on customers. The combined impact of these changes may have wider macroeconomic and policy implications which are as yet unquantifiable.

Our research considers the potential costs and benefits, both financial and behavioural, of the proposals, as well as a number of illustrative examples of the potential impact. Given the potential costs there are important questions relating to the benefits of the Duty that have not yet been answered, and which it is imperative that the FCA addresses before deciding how to proceed.

1) **Against which harms are these actions targeted to deliver?** The report describes the types of harms that might be addressed with the new Duty. Many potential harms can be addressed by current regulatory tools, are outside the regulatory perimeter, or are carried out by 'bad actors' who are already acting outwith the regulatory system. Only those harms which fall into none of these categories will be addressed by the proposals, and it is not clear what the FCA considers these to be. Are the proposed actions additive, or is the problem that the tools currently available to the regulator are not being used as effectively as they might?

2) **Will the proposals address these particular harms?** Many of the compliance and behavioural costs identified in the research will apply across all products and services, not only those where harms have been identified, significantly adding to an imbalance in costs versus benefits.

3) **What are the possible unintended impacts?** Given that a highly experienced economic consulting firm, and the industry itself, cannot quantify what the impact might be, it is clear there is a high risk of unintended consequences. These could include service withdrawal (which in the Panel's view is likely to have a greater impact on customers in vulnerable circumstances), constraints on innovation, and interaction with SM&CR that will likely have a negative impact on retention and recruitment of talent.

The way forward

The consultation considers two alternative wordings, whether the new consumer duty should be that firms should seek to deliver "good outcomes" for customers, or that firms should act in their customer's "best interests", both underpinned by a requirement for firms to take <u>all</u> reasonable steps to avoid causing foreseeable harm and to enable customers to pursue their financial objectives. This could be accompanied by a Private Right of Action (PROA).

In the Panel's view, a 'good outcomes' principle appears more likely to achieve the FCA's intention, as set out further in the Rules and Outcomes, with less uncertainty and risk for firms than a 'best interests' principle may cause. This view depends on how the FCA sets out its Rules and to a large extent on the introduction of a PROA.

The Panel believes the expected costs of the 'best interests' wording are greater than those of the 'good outcomes' wording. This reflects the potentially higher standard of 'best interests' and uncertainty over how firms should interpret this, relative to 'good outcomes'. Even so, expected costs under either wording of the Principle are in the 'medium to high' range and it is uncertain whether the proposals will result in a net benefit overall. There is a significant increase in costs expected from the introduction of a PROA that increases expected costs to a 'very high to extreme' level.

In raising standards the primary intention of a new consumer duty should be to ensure that more people are provided with financial services consistent with that duty than prior to its introduction. That would be the net increase in social utility such a change must bring about. Our focus on fine tuning is to help ensure that happens - recognising that the unintended consequences of rushed regulation (including subtle differences in key words) could lead to the opposite outcome.

Costs include not only those which must be borne by firms, but costs for consumers in terms of products and services withdrawn, or the opportunity cost of innovation which cannot be pursued. Solutions which will not address identified harms, or which impose costs where harms have not been identified, benefit no one. Given the time available, and the huge unknowns, the Panel strongly counsels the FCA to be very specific about the harms it wishes to identify and to take the least high-risk approach to implementation.

Yours faithfully,

Paul Feeney
Chair, FCA Practitioner Panel