Financial Services Authority

Treating customers fairly – towards fair outcomes for consumers

July 2006

We would welcome any comments on issues raised in this document. You can send us comments by e-mail: tcf@fsa.gov.uk.

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Contents

1 Overview

1.1 The purpose of this paper is to:

- explain the outcomes for consumers that we are looking to achieve through our Treating Customers Fairly (TCF) initiative;
- provide an update on the progress firms are making with delivering these outcomes, based on firms' own assessment and the findings of our work; and
- outline those areas where further work is required and how we expect firms to take this work forward.

Key messages

- The Treating Customers Fairly (TCF) initiative aims to deliver six improved outcomes for retail consumers – firms should be focused on trying to achieve these outcomes.
- Firms should by now be seeking to make TCF an integral part of their business culture. TCF is a continuous process – it is not something that firms can implement and then forget about.
- There is mixed progress to report amongst firms implementing their TCF strategies – some are making good progress (with a high level of commitment shown) but others are lagging behind.
- A majority of firms say that they are implementing TCF programmes, but even in these cases we have found that high levels of senior management commitment to the fair treatment of customers are often not yet reaching the front-line of firms' activities.
- An example of where there is still some way to go is in quality of advice, where firms need to improve the way they give financial advice to retail customers in order to reduce the risk of mis-selling.

- For the minority of firms lagging behind in their TCF work, we have set a target – we expect all firms to have reached at least the 'implementing' stage of their TCF work in a substantial part of their business by the end of March 2007. We will be using this as a benchmark when reviewing firms' progress.
- Next year, we expect to start seeing measurable change in outcomes for consumers – both through management information implemented by the industry and in our own firm-specific and thematic supervision work.
- We expect to continue to bring enforcement action in respect of matters relating to TCF.
- We will provide support, for example through training and targeted communications, to continue to help firms implement TCF.
- We will invest further in our own internal systems and training to help ensure that our supervisors have the tools they need to help facilitate firms' efforts to implement TCF.
- We welcome the work of many trade associations in helping to translate the concept of TCF for their members.

Consumer outcomes

1.2 Through our TCF initiative we have focused on giving the requirement to treat retail customers fairly renewed emphasis. Our aim has been to see a step-change in the behaviour of the financial services sector and therefore to deliver improved outcomes for retail consumers. The outcomes are summarised below and explained more fully in Chapter 2.

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.

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.

Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.

Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances.

Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.

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.

1.3 We aim to deliver these outcomes through changes in the activities of regulated firms operating in the retail market. Consumers – and in particular improvements in their levels of financial knowledge and their behaviour – can also play a part in the overall delivery of these outcomes.

TCF – a core part of our retail regulatory approach

1.4 The requirement on firms to treat their customers fairly is not new: it is part of existing regulatory requirements and is firmly rooted in our Principles for Business. Principle 6 states: '*a firm must pay due regard to the interests of its customers and treat them fairly*'. Other Principles are also relevant when taking a rounded view of what fair treatment might mean.[1]

1.5 The TCF initiative is also central to the delivery of our overall work in the retail market. Our retail regulatory agenda aims to ensure an efficient and effective market and thereby to help consumers achieve a fair deal. We work to achieve this through a focus on:

- capable and confident consumers;
- simple and understandable information for, and used by, consumers;
- well managed and adequately capitalised firms who treat their customers fairly; and
- risk–based and proportionate regulation.

1.6 The TCF initiative is related to all of these. In particular, the current level of consumers' financial capability has an impact on our approach to TCF; the provision of simple, understandable information is a key element of TCF; and TCF is also a key component of our risk-based approach to regulating firms.

1 For example:

- Principle 1 – '*A firm must conduct its business with integrity*'
- Principle 2 – '*A firm must conduct its business with due skill, care and diligence*'
- Principle 3 – '*A firm must take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems*'
- Principle 7 – '*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 8 – '*A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client*'
- Principle 9 – '*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 judgement*'

TCF and principles-based regulation

1.7 In renewing our emphasis on the fair treatment of retail customers, the regulatory approach we have chosen to take is entirely consistent with our better regulation agenda as described in our Better Regulation Action Plan.[2] In particular, the TCF initiative is a core part of our move to a more principles-based approach to regulation.

1.8 We see real benefits for consumers in tipping the balance of our regulation more towards principles and away from prescription. We believe that a more principles-based approach will help to align good business practice in firms and markets with our own statutory objectives.

1.9 As part of the move towards a more principles-based approach we are keen to avoid introducing new detailed rules. And we are working to remove such rules where possible, for example by simplifying the Conduct of Business Sourcebook for investment business. So we do not envisage introducing new rules as part of the TCF initiative; instead we want firms and their senior management to focus on the principles and the outcomes for consumers that we are looking to achieve.

1.10 We recognise that some firms may prefer the clarity and certainty associated with a rules-based approach. As part of our TCF initiative we have used a range of approaches – for example the publication of case studies and of statements of good and poor practice – to help firms to interpret the meaning of relevant principles and to challenge firms to review their practices and to facilitate change. And we believe that trade associations and other organisations can have a significant role in helping firms in different sectors to develop acceptable practices within a more principles-based regime, for example through industry codes and other guidance materials.

1.11 The Principles are themselves rules. And some aspects of what is meant by the Principles have been fleshed out in our more detailed rules. So, despite our move to simplify rules where possible, some detailed rules will remain and compliance with them will remain an important aspect of treating customers fairly. From time to time, we may also choose to produce more formal illustrative guidance.

1.12 We realise that a more principles-based approach poses challenges for our own staff as well as for firms. In particular, it is important that our supervisors have the tools they need to help facilitate firms' efforts to implement TCF and to form the types of judgement that more principles-based regulation requires.

2 See 'Better Regulation Action Plan – what we have done and what we are doing', December 2005, www.fsa.gov.uk/pubs/other/better_regulation.pdf; and
'Better Regulation Action Plan – Progress Report', June 2006, www.fsa.gov.uk/pubs/other/2660_Action_plan.pdf.

TCF – the story so far

1.13 This paper builds on our previous published material. In our July 2004 report 'Treating customers fairly – progress and next steps' we suggested that the product life-cycle offers a practical framework for considering TCF. For firms which are service providers and not involved in the direct supply of products, some elements of the product life-cycle will be less relevant, but these firms should still consider how TCF applies to their activities.

Relying on our general regulatory approach of the responsibility of senior management, we are looking to them to embed the principle of TCF in their corporate strategy and to build it into their firms' culture and day-to-day operations. This means addressing the fair treatment of customers through the product life-cycle, including:

- product design and governance;
- identifying target markets;
- marketing and promoting the product;
- sales and advice processes;
- after-sales information and services; and
- complaint handling.

1.14 In our July 2005 paper 'Treating customers fairly – building on progress' we drew on findings from our cluster work to highlight good and poor TCF practice at different stages of the product life-cycle. The report also contained some good and poor practice connected with wider strategic and cultural issues within the firm and an assessment of industry progress.

Our work in the last year

1.15 In the last year, our TCF work has focused on the following areas:

- We have conducted a survey to review how far firms themselves think that they are making progress with their TCF initiatives (we report the findings in Chapter 3).
- We have undertaken further work on management information used by firms for measuring TCF (we summarise the findings in Chapter 3).
- We have challenged individual firms in the course of our risk assessments and in the light of our thematic work to consider the changes they need to make and to press on with them.
- We have recently completed a study of good and poor practice when firms give advice on retail investments. We have published our findings to stimulate action (we summarise the findings in Chapter 4).

- We have undertaken specific cluster work to identify TCF issues in the mortgage and general insurance sectors. We have published our findings to stimulate action (we summarise the findings in Annex 1).
- We have published further case study material on designing and selling a new product, marketing and promotion, and quality of advice. Earlier in the year, we published case studies on controls within networks, managing unexpected events, complaints handling, remuneration of staff and management, management information and closing a with-profits fund.

1.16 A full list of all our published TCF materials – available on our website – is included as Annex 2.

1.17 In publishing this material we emphasise our view that TCF is not a 'one-size-fits-all' concept and it is for senior management to decide what TCF means for their particular firm. Generally, the examples of good and poor practice that we publish are to help firms and their management make that decision: we think the good practice is likely to help a firm treat its customers fairly and the poor practice is likely to get in the way of a firm doing so. We recognise that smaller firms have fewer resources to implement change and intend to produce further material on TCF for their use. We have undertaken analysis of the respective responsibilities of product providers and distributors and anticipate sharing this in due course.

1.18 Trade associations have again been engaged actively in TCF work in the past year. This has included considering TCF issues relevant to their sectors and providing material for their members to help them develop their approach to TCF. Annex 3 provides a summary of various initiatives underway.

Progress with TCF – a mixed picture

1.19 The TCF initiative starts from the position that the vast majority of firms intend to treat their customers fairly. Indeed, what is required of firms varies considerably depending on their starting point. And in reaching an overall view on industry progress with delivering the TCF consumer outcomes we note that the position is complex – every firm is unique, and the challenges that firms face will depend on a range of factors including size, structure, and the sector and markets in which they operate.

1.20 Overall, however, we believe that the current picture on TCF implementation is mixed.

1.21 At one end of the scale, many firms tell us that they are making good progress. Most firms sampled tell us that they have reached the 'implementation' phase of their TCF initiatives. We welcome these reports of progress and the messages confirming senior management engagement and willingness to lead change. And we are encouraged that in many firms senior management are providing leadership rather than (or as well as) the lead being taken by compliance staff. However, even in these firms, the findings of our thematic and other work suggest that the good intentions and strong leadership of senior management are not yet translating in all cases to good outcomes for consumers.

1.22 At the other end of the scale, there are firms that either deny that TCF applies to them or who have been slow to introduce a review of existing practices and consider properly whether change is necessary. A minority of firms fall into this category. There may be firms that look at their approach and identify that they do not have gaps or issues to address. However, many firms find, when they look closely at their business and operating practices, that cultural or process issues can inhibit their ability to treat customers fairly in practice. We therefore generally expect firms to find that there are changes to make.

Next steps for firms

1.23 Taking into account their starting point and progress made so far, firms need to continue to focus on TCF and to progress towards embedding TCF throughout their activities. We understand that cultural change takes time, but expect now to see more widespread changes in outcomes as well as process – whether measured through a firm's own management information or our continuing firm-specific and thematic supervision work. We believe that this will require sustained effort and leadership from senior management.

1.24 To stimulate action in firms that are so far being slow to appreciate the significance of TCF, we are introducing a deadline. We expect that all firms should be at least in the 'implementing' phase of their TCF work in a substantial part of their business by the end of March 2007.

Next steps for the FSA

1.25 Over the coming year we will continue to treat TCF as a priority. TCF is already a key part of our regulatory approach for the retail market. And we will continue to work to embed TCF within all aspects of our regulatory and supervisory approach. This will include aligning all relevant thematic work with our TCF priorities and drawing out messages from the findings of our thematic and firm-specific work on progress with TCF.

1.26 We will provide support, for example through training and targeted communications, to continue to help firms implement TCF. We will invest further in our own internal systems and training to help ensure that our supervisors have the tools they need to help facilitate firms' efforts to implement TCF.

1.27 We will take forward work to review firms' own assessments of progress with their TCF initiatives. We will look to firms to demonstrate – for example using their own management information – how they are building TCF into their strategy and approach. We will also carry out targeted work on those aspects of the consumer outcomes where we are less well-informed, notably on product design and the cultural questions around how firms translate good intentions into delivery in the form of improved outcomes for consumers.

1.28 We will continue to consider enforcement action in circumstances where a firm's systems or actions leave open the potential for significant consumer detriment, or where actual significant detriment has occurred. This is much more likely to be our response where firms continue to deny that TCF has any relevance for them or have failed to take appropriate steps to work out what changes may be required and to start implementing them. We will also consider taking action against individuals within the firm if we consider that senior management have failed in their responsibilities.

1.29 Until we are satisfied that we have achieved substantial progress towards our outcomes, the TCF initiative will remain a central element of our work to deliver an efficient and effective retail market. As such we do not have a target date for its 'completion'.

Scope

1.30 The TCF initiative is relevant to all firms who are involved in the retail supply chain, whether they have a direct interface with the customer or not and whether or not they are involved in all stages of the product life-cycle. This includes firms providing services as well as those producing or selling products.

1.31 'Provider' firms that are not 'end-distributors' (in other words they are not directly selling products to or advising customers themselves) still need to consider their impact on the end-customer. We believe that providers are likely to have a role in designing and targeting products; providing communications to those firms which sell retail products to consumers or to the consumers themselves; and post-sale service where they acquire an ongoing contractual relationship. Distributors for their part will generally be responsible for the sale including information provided and for the suitability of any advice. However, the chains created are often complex and, as already mentioned, we have undertaken an analysis of the responsibilities of different firms involved in retail distribution chains and anticipate sharing this analysis in due course.

Who should read this paper?

This paper is aimed at regulated firms operating in the retail financial services market. The paper is relevant to all firms, but we are publishing a separate short guide for smaller firms to help them navigate this paper.

The paper should also be of interest to consumer groups.

2 Achieving a fair deal for consumers

2.1 We have developed six consumer outcomes which explain what we want the TCF initiative to achieve. We aim to deliver these outcomes through changes in the behaviour of regulated firms operating in the retail market. Consumers – and in particular improvements in their levels of financial knowledge and their behaviour – can also play a part in delivering the outcomes. Similarly, competitive markets can help to ensure fair treatment of consumers by delivering improvements in aspects of the products and services firms offer, for example by improving product design, quality of service or value for money. But neither consumers nor price competition can deliver fairness alone.

2.2 We encourage firms to consider these consumer outcomes when implementing their TCF initiatives and in assessing whether the changes they are implementing are having an impact.

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture

2.3 TCF is a cultural issue. As such, we expect it to be driven from the top, and from all firms we expect demonstrable commitment from senior management. We have encouraged firms to think about TCF using the product life-cycle approach, and this has raised cultural questions about connectedness and consumer focus within firms. TCF should be reflected in the approach taken to human resources and reward within an organisation as well as the front line business areas. It should be taken into account when corporate strategy is determined and when standard form consumer contracts are drafted. Senior management and the board should receive management information that enables them to assess whether customers are being treated fairly. Putting consumers at the centre of the corporate culture means that TCF, rather than simply being about process, should translate into practical outputs in the shape of fair outcomes for consumers.

2.4 We accept that this kind of cultural shift is challenging and will take time to embed. Particularly in larger firms it is quite common for there to be a substantial time lag between senior management action and change in terms of the systems and processes applied at working level, staff behaviours and the resulting outcomes for customers.

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

2.5 Products and services need to be designed with the intended market in mind. Equally, it is important they are targeted appropriately, to minimise the risks that the marketing might lead those for whom they are unsuitable to buy them.

Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale

2.6 Clear communication is a key component of firms' approaches to TCF as well as to Principle 7 – '*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*'. Before and at the point of sale we expect that all financial promotions should be clear, fair and not misleading. Effective point of sale disclosure is also essential to enable customers to understand the characteristics of the product they are buying and to help them understand whether and why it meets their requirements. Post-sale disclosure plays an important role in helping to ensure that consumers are kept aware of product performance, their opportunities to act at certain points in the product life-cycle and changes in the terms and conditions.

Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances

2.7 Delivering suitable advice – where a firm has chosen to offer it – is a key component of TCF as well as Principle 9 – '*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 judgement*'. Where consumers have obtained a recommendation, the advice must reflect their needs, priorities and circumstances.

Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect

2.8 TCF involves being clear about what product or service is being provided and the range of possible results and experiences for the consumer. For products which involve market risk for the buyer, there needs to be clarity about the possible impact of, for example, stock market movements; for general insurance, clarity about exclusions and therefore likelihood of being able to claim. Consumers can, of course, be fairly treated even if the product they purchase performs poorly, for example equity market falls can lead to losses; interest rate rises lead to higher mortgage payments; and some insurance claims will fall into exclusions. But there can be fairness issues where the consumer is misled about the possible performance of the product. Once acquired, the service level should at least be acceptable (for example, no undue delays) and certainly no different from that actually offered.

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

2.9 Post-sale barriers to fair treatment can be cultural, contractual or competitive. We have previously set out our concerns about post-sale barriers.[3] The consumer ought to be able to change products or switch providers without incurring excessive penalty. Similarly, firms should not make it unnecessarily difficult for consumers to make claims or to complain when something goes wrong.

Measuring progress

2.10 In developing these outcomes, we have considered how we will measure progress towards their achievement and what indicators we will use. We have looked to maximise the use of existing data wherever possible, from consumers, the FSA and firms themselves.

2.11 Some of the measures that we will use include:

- findings from any TCF or other relevant thematic work;
- findings from our day-to-day supervision of individual firms: as part of our supervisory work, we will continue to challenge firms and their senior management on how they satisfy themselves they are treating their customers fairly, including through use of their management information; and we will also assess the nature and level of TCF risks within the firm, looking at a range of available indicators;

3 'Treating Customers Fairly After the Point of Sale', June 2001, www.fsa.gov.uk/Pages/Library/Policy/DP/2001/discussion_07.shtml.

- our Financial Capability Baseline survey[4] (and its repeats), which is an important source of intelligence on financial literacy and consumer behaviour, helping firms and us to target their and our efforts on TCF;
- FSA consumer research, including mystery shopping exercises or generic consumer research; and
- relevant data provided directly to us by firms or the Financial Ombudsman Service (FOS), for example complaints data.

2.12 Chapter 4 provides an initial assessment, based mainly on our thematic and TCF cluster work, of firms' progress in delivering these outcomes for consumers in practice.

Consumer responsibility

2.13 Having set out our intended outcomes it is appropriate to consider the role consumers themselves can play in achieving them. The Financial Services and Markets Act (FSMA) 2000 states that our 'consumer protection' objective must have regard to 'the general principle that consumers should take responsibility for their decisions'. An efficient retail market relies as much on capable and confident consumers as it does on firms who treat their customers fairly.

2.14 Consumer responsibility is therefore vital to the effectiveness of financial markets. This is not to say that consumers must always bear such responsibility regardless of what was said or done to them by the seller. That view may have prevailed once, but the trend over 250 years of English law has been away from 'caveat emptor' ('let the buyer beware'). Case law and consumer legislation have spelled out with growing clarity that particular acts or omissions by sellers will reduce the buyer's responsibility for an unhappy outcome.

2.15 In addition to this broad legal basis for qualified consumer responsibility, FSMA goes further in recognising that, for financial services, it is only reasonable to expect consumers to exercise responsibility for their decisions if we address some of the inherent difficulties in the market. Specifically, FSMA states that appropriate consumer protection must have regard not only to the principle of consumer responsibility, but also to:

- the needs that consumers may have for advice and accurate information;
- the differing degrees of experience and expertise that consumers may have in relation to different kinds of products or services; and
- the differing degrees of risk involved in investments or other transactions.

4 'Financial Capability in the UK: Establishing a Baseline', March 2006, www.fsa.gov.uk/pubs/other/fincap_baseline.pdf, to be repeated in the next 4-5 years.

2.16 We intend that, through TCF, firms will become more sensitive to their customers' needs and requirements, so that as firms change their behaviour they can contribute to consumers taking more responsibility for their own decisions, and help them to bear this responsibility effectively.

2.17 However, it must be recognised that while consumers might be expected to take greater responsibility, firms need to be aware that poor levels of financial capability may make it difficult or impossible for them to do so. We hope that over time our national strategy for financial capability will help consumers become better able to take responsibility for their financial affairs.

2.18 We believe that this approach and its foundation in FSMA provides a coherent high-level approach to consumer responsibility. However we recognise that this leaves some difficult questions open – in particular, does the consumer have concrete responsibilities as well as rights? And if so, does failure to discharge those responsibilities weaken those rights? In our July 2005 publication 'Treating Customers Fairly – building on progress', we invited the Consumer Panel and Practitioner Panel[5] to debate such matters in the context of an advised sale of an investment product.

2.19 There was substantial agreement between the Panels on the nature of firms' responsibilities. What was gratifying in the context of the TCF initiative was that there were several things the FSA does not prescribe in detail, but which both Panels agreed were important responsibilities of firms contributing to the fair treatment of consumers.

2.20 For example, they agreed that firms should:

- take into account at the product design phase the types of consumer being targeted and their appetite for risk;
- support sales staff and other distributors by helping ensure that they understand the target market;
- consider their remuneration policies and the controls in place to manage the associated risks;
- take particular care when dealing with less financially-capable customers; and
- provide adequate opportunity for customers to ask questions.

2.21 There was also a high level of agreement about what it was sensible for consumers to do to protect their own best interests when potentially making a financial decision during an advised sale. This included to:

- read advertisements and other material carefully;

5 The FSA has a statutory duty to consult with and consider representations from practitioners and consumers through the independent panels.

- engage properly with the firm and provide accurate information, raising questions if uncertain about any aspect;
- read any suitability letter and ensure that it properly reflects the discussion;
- use cooling off periods to consider whether to go ahead;
- review financial needs on a regular basis and consider taking further advice when circumstances change; and
- complain to the firm if they perceive unfair treatment.

2.22 The Panels agreed that if consumers do all these things, then they will have maximised their chances of:

- making a good decision that is in their own best interests;
- protecting themselves against any improper or poor quality behaviour by the firm; and
- putting themselves in a position to tell as good and persuasive an account as possible of their own actions and thought processes to a court or ombudsman, should any dispute over the transaction go that far.

2.23 There was less agreement among the Panels when they considered whether such sensible consumer actions could or should be described as responsibilities and the consequences for consumers of failing to do these things.

2.24 The FSA's approach to these issues is that it is reasonable that, where a firm fulfils all its obligations and treats the customer fairly, then even if a transaction turns out to be disappointing for the customer this should not be blamed on the firm. Otherwise fear of unpreventable liabilities would deter business to the detriment of firms and customers. Furthermore, the absence of reasonable care on the part of the customer might be a relevant consideration when a complaint against a firm by a consumer is being considered by the firm, by the FOS or by the courts. Put simply, if customers fail to take reasonable care they may find that they reduce the protection they can expect under the law.

2.25 But, in a strictly legal sense, consumer actions cannot be described as responsibilities. And when considering complaints, firms need to examine the circumstances of the individual case carefully. An attempt to shift responsibility onto the consumer just on the basis that he or she has not read the written contract will often be simplistic and will not be treating the complaint fairly.

Consumers' financial capability

2.26 It is instructive to set this analysis of a desirable position alongside the findings from our baseline survey on the levels of financial capability in the UK. First, it is notable that steps thought to be sensible for consumers to take include reading and understanding the material produced by firms. Our baseline survey showed that customers generally do use materials, but we still found poor levels of understanding for some products, particularly investments. Firms can capitalise on customers' willingness to read materials if they ensure the material they produce is fit for purpose – in particular clear and jargon free. We continue to see poorly-produced information which inhibits the customer's ability to understand properly the characteristics of the product.

2.27 Second, the sensible steps for consumers involve a regular review of financial needs and consideration of further advice. As part of our baseline survey work we found poor levels of financial planning and review on the part of consumers. The ability to plan and review finances effectively is dependent on adequate levels of financial capability and the availability of financial advice. For example, we found that 40% of people who owned an equity Individual Savings Account (ISA) were not aware that its value would fluctuate with stock market performance. Without understanding the characteristics of the products they hold, consumers will not be able to review their finances with competence. Firms can take this into account in their communication with customers.

2.28 Third, the sensible steps also involve complaining when things go wrong. The survey revealed that approximately half of those who believed they had been mis-sold took action and only 20% felt they had been able to resolve the issue. Firms can take this behaviour into account by having a process for handling and settling complaints which is as accessible as possible.

2.29 There is therefore a gap between sensible steps for consumers and their existing financial capability. Firms can take some steps to help to close this gap. In the longer term our national strategy for financial capability is intended to equip consumers with the skills they need to make confident decisions. We are also adopting a more strategic approach to our consumer communications, and will provide consumer information and services in a more accessible and engaging way. In particular, we are redeveloping our consumer website[6] and will promote more effectively the information and services that it provides.

6 See www.fsa.gov.uk/consumer.

2.30 In the meantime, the lack of financial capability is still a significant issue. In particular, our baseline survey highlighted younger people and the over 70s as being less capable and this is something that firms should bear in mind when developing their approach to TCF. We intend to build on this analysis and will be holding a seminar for firms on the results of the baseline survey and their relevance to their approach to TCF.

2.31 We have also analysed the results of the baseline survey to see whether we can learn lessons relevant to our TCF initiative (and with a view to analysing future iterations of the survey to measure TCF progress). Our findings can be found throughout Chapter 4.

3 Industry progress

3.1 In our July 2005 report 'Treating customers fairly – building on progress' we suggested that firms might be categorised into four groups when assessing progress on TCF – those that are simply aware of the initiative; those involved in strategy and planning, including conducting a gap analysis to establish what areas might need to be tackled; those implementing change; and those embedding TCF into their business. We surveyed firms to establish where they believed they had reached against each of these phases.

3.2 We repeated the survey this year to review how firms themselves think they are progressing on TCF. For consistency we have used the same categorisation as in 2005. The results which follow are based on the answers from 143 firms surveyed in Spring 2006. The firms told us where they are with their TCF initiative and provided information on what they are doing at each phase.

Defining Progress

3.3 The four phases of progress are defined below. In setting out these phases we do not intend to be prescriptive about how firms should approach TCF, but to set out a possible structure.

- Aware – analysing the situation.

Firms reported reviewing FSA material, attending workshops and conferences, holding their own workshops to identify what TCF means for them, engaging with staff and, where they wanted to, seeking the advice of consultants.

- Strategy and Planning – determining the extent of any change required in the firm; articulating that change; involving the key players; communicating; and undertaking a gap analysis.

Firms reported that senior management have become engaged with the TCF initiative and some have conducted a gap analysis. Some firms, for example, have set up senior management committees to oversee the TCF strategy, others have a board level champion for TCF. We have also seen some firms set out their strategic approach to TCF by incorporating it into their mission statements or a statement of how TCF applies to their business. Others have set up specific projects on different aspects of TCF as it applies to their business.

- Implementing – allocating resources and responsibilities; developing plans and processes; and creating capability.

Firms reported tackling issues highlighted by the gap analysis. Some firms also implemented their own training programmes and guidance for staff. Firms also looked at management information and internal audit in order to measure performance.

- Embedding – following up on implementation; continuous monitoring of TCF performance and commitment to maintaining standards in the future.

Firms reported undertaking further gap analyses and assessments as well as identifying further improvements as highlighted by their management information, audit, complaints, compliance reviews and staff feedback.

3.4 During the year, we have particularly thought more about what a firm that is successfully embedding looks like. We believe that the embedding phase, and achieving a step change in behaviour, is characterised by the following:

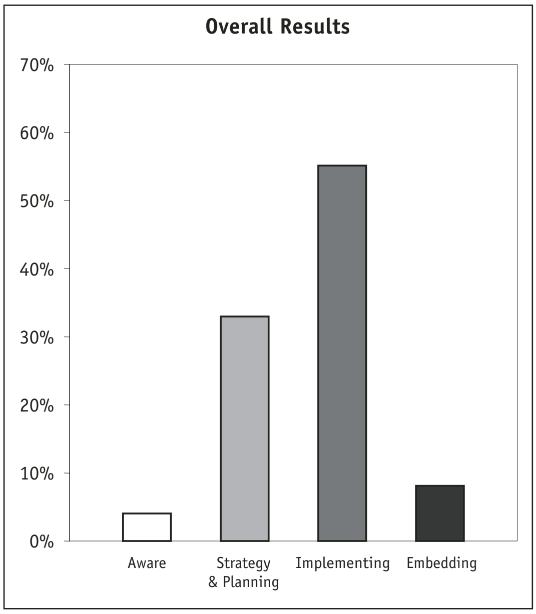
- the fair treatment of consumers is established throughout the firm – not just in systems and controls but in business culture including strategy, training, remuneration and staff behaviours;
- recognition that the firm is engaged in a continuous process – rather than being a short-term project that can be completed and then put to one side, TCF should be built into processes and strategy so that it is automatically taken into account in all relevant business decisions (for example when new products or services are launched);
- adequate management information available for firms' management to monitor TCF; and
- improvement in the quality of the outcomes experienced by the firm's customers.

3.5 A firm could demonstrate this by showing us that it has completed its implementation plans, resolved any outstanding issues relating to TCF practices, and put in place means of monitoring/measuring the fair treatment of consumers (at very senior level) and of ensuring that the impact on fair treatment is considered in strategic and business decisions.

Measuring Progress

3.6 The overall results from our sample are represented at figure 3.1. Of the firms that we surveyed 80% of large firms/groups and 51% of medium-sized firms considered themselves to be at the implementing or embedding phase.

Figure 3.1



3.7 Last year we reported that progress with the TCF initiative had been most advanced in the major retail groups, with medium-sized firms generally some way behind. This year we surveyed a larger sample of firms and, while the sample sizes are different, our results suggest that firms generally are moving forward. The major retail groups are again reporting that they are making the most progress. While we are broadly encouraged by the findings overall, we do have some concerns about the slower progress of medium-sized firms. Chapter 6 sets out some of the work we plan to remedy this deficit. Figures 3.2 and 3.3 illustrate the findings by size of firm and show progress made over the last year.

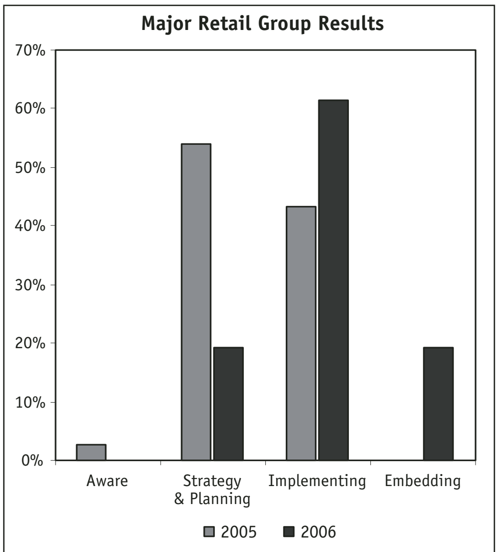
Major retail groups

3.8 We sampled 36 major retail groups[7] and received 57 responses (some groups submitted responses from business units). As the number of responses shows, some groups chose to differentiate progress across the group. This can in itself be an indicator that the group is making progress with TCF as it is considering what is appropriate for its individual business units and ensuring that the TCF initiative permeates throughout the business in a risk-based way.

7 Firms supervised in our major retail groups division.

3.9 These largest groups have had significant dialogue with us on the subject of TCF and we are satisfied that in most cases they are devoting resources to make TCF a reality. We welcome the progress made by major retail groups with their TCF implementation programmes and encourage them to maintain this momentum. We do note that a number of responses report that business units are still at the strategy and planning phase and we would like to see these firms progressing quickly to the implementing phase.

Figure 3.2



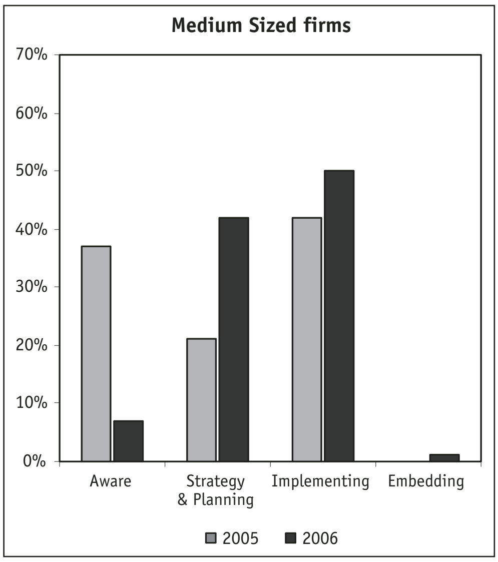
2005 sample is based on results from 37 major retail groups

Medium-sized firms

3.10 We received responses from 86 medium-sized firms.[8] Overall these firms report slower progress. There has been an improvement since the Spring 2005 survey when a large percentage of medium-sized firms reported they were at the aware phase. However, we are concerned that such a large proportion of firms report they are still at the strategy and planning phase and would like to see all firms in this category progressing quickly to the implementing phase. We also encourage those firms who are moving through the advanced phases of implementation to sustain their efforts. Figure 3.3 illustrates the proportion of firms at each phase and the progress made over the last year.

3.11 The sample includes a small number of wholesale firms. TCF is relevant to wholesale firms where their activities include a business which deals directly with retail customers or where they originate products which are distributed by other firms to retail customers. Our sample was drawn from firms which deal directly with retail customers. The majority of those firms surveyed considered themselves to be implementing TCF. All firms surveyed had undertaken some research on how to implement TCF into their business practices.

Figure 3.3



8 The sample is dominated by firms supervised in our retail firms division, but also includes a small number from each of our wholesale firms and small firms divisions. In the latter case it is the larger small firms that are covered.

3.12 We chose not to survey smaller firms as they are least likely to approach TCF in such a structured way and to be measuring progress using the phases described above. We have, instead, looked at the progress of smaller firms as part of our day-to-day supervision. Our findings are outlined in Chapter 4.

Sustaining the momentum and setting a benchmark

3.13 We are keen that the industry continues to build or sustain momentum on the TCF initiative. We do, however, recognise that for individual firms delivering any cultural changes needed for TCF will take time. Firms are starting in different places, so some will have further to go. Firms have also adopted different approaches to the TCF initiative, and these will take varying amounts of time to deliver. We do not see the delivery of TCF within each firm as a strictly sequential process. Different parts of the firm/group may be at different phases. Furthermore, we are interested in the quality of what the firm is doing and how this is changing behaviour, rather than simply the speed with which the firm is progressing through an action plan. We therefore expect that it could take some time before some firms have satisfied themselves they have reached the 'embedding' phase.

3.14 Having said this, TCF is one of our Principles and the TCF initiative has been an FSA priority for more than two years. We therefore encourage firms to move ahead with their TCF initiative, regardless of what phase they are currently at. At the very least, we expect firms to be at the implementing phase in a substantial part of their business by the end of March 2007. We will use this as a benchmark when reviewing firms' progress with TCF implementation, whether as part of firm-specific supervision or relevant thematic work. We recognise that if firms pursue TCF in a risk-based way the constituent parts may not progress at the same rate but we would expect the substantial part of the business to have reached the implementing phase by our deadline.

3.15 Based on our discussions with firms we have found that most firms, once they consider their approach to TCF, find that there is some action or change required. There are some firms who have advised that TCF does not apply to them because they already embody it or because of the nature of the sector in which they operate. These firms will need to be able to satisfy themselves and us that TCF is embedded in all aspects of their culture and activities, or that all of their regulated activities are carried on with or for market counterparties.

3.16 We encourage firms who are already well advanced in their TCF work to maintain their momentum. We believe, and many firms tell us, that it is in firms' own commercial interest to raise standards of customer treatment. Furthermore, where senior management successfully show an appreciation of what is required by the TCF initiative (and principles-based regulation more generally) we are able to make our regulation less intrusive.[9]

Monitoring TCF performance – Management Information

3.17 Having determined the programme for achieving TCF, senior management will need to use appropriate management information to measure whether they are treating customers fairly and whether their aspirations for change are being realised throughout the business. Identifying appropriate management information continues to be a challenge for many firms. In particular, it is essential that firms use measures that distinguish between customer satisfaction and fair treatment of customers. The poor financial capability mentioned in Chapter 2 means that fairness and satisfaction are unlikely to be synonymous. A customer can, for example, be satisfied with an unsuitable product or dissatisfied with an entirely fairly adjudicated general insurance claim. Until senior management are able to judge the firm's performance against appropriate management information, it will not be possible for them to assess their TCF performance adequately or to conclude they are embedding.

3.18 To find out how firms are approaching the use of management information for TCF we surveyed a sample of different sized firms (excluding the very small) across a range of sectors.[10] Our detailed findings, including the types of management information firms are using, are set out in a separate cluster report on our website.[11] We consider that it is for firms to determine for themselves what type of management information is required, according to the nature of the business they undertake. We also do not expect that TCF should require substantial amounts of new information but that firms can perhaps think differently about data that are already available. This has been confirmed by our survey. Most firms surveyed reported that they expected less than 20% of their TCF management information to be derived from new or additional data.

3.19 The results showed that few firms had fully implemented their TCF management information programmes. The majority expect to do so by the end of 2006 and TCF management information is therefore one of the last elements to be addressed within firms.

9 See, for example, John Tiner's speech, 'Principles-based regulation & what it means for insurers,' March 2006, www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0320_jt.shtml.

10 For the management information survey we sent a questionnaire to a sub-set of those firms who reported on their progress with the TCF initiative more generally, as outlined in paragraphs 3.6 to 3.11. We asked the firms about what management information they had developed, what they used it for and who reviewed and dealt with the management information. We received responses from 44 firms. PricewaterhouseCoopers assisted us with the analysis.

11 Management Information cluster report, July 2006. See www.fsa.gov.uk/tcf.

3.20 An overview of the key findings from the management information survey is set out below:

- It was encouraging to see that firms consistently involve senior management in reviewing the TCF management information they have identified or developed so far.
- Progress towards implementing TCF management information measures was not consistent across all firms. Those firms with a strong retail customer base, significant resources, and exposure throughout the product life-cycle tended to be more advanced.
- Many firms had difficulty differentiating between the evidence they use to demonstrate that they are taking forward TCF processes generally and management information measures appropriate to assess that those processes are in fact delivering fair outcomes.
- It was not clear that firms were managing to capture fairness rather than customer satisfaction.
- Firms collect information on sales and complaints but product design, financial promotions and information after the point of sale are areas where there has been slower progress in identifying appropriate management information.
- Although many firms collected qualitative input from customers and/or staff, only a few of the larger firms used it to inform the product development process. Such input was gathered in the form of surveys or focus groups.
- While firms do have a clear review process for management information, it is often not evident how firms follow up the issues identified by the management information and how they monitor remedial actions.

3.21 Many firms use customer satisfaction surveys to understand the customer experience. To enable them to capture fairness firms may find it useful to refine their questions. For example, rather than simply asking a customer if they are satisfied with or understand a product or service – or in addition to doing that – firms could frame questions designed to test how far the customer understands the product or service being provided and how far it meets their expectations such as ‘What does this product do?’ or ‘Why did you buy this product?’.

3.22 Some examples of good practice in relation to the collection and use of management information throughout the TCF product life-cycle are set out in our cluster report.

4 What is our work telling us about progress?

4.1 Having considered in Chapter 3 firms' views of their progress in implementing TCF, we set out in this chapter an assessment, based on our own work with firms, of how far the industry as a whole is successfully delivering the desired TCF consumer outcomes. We also summarise some specific considerations for smaller firms.

4.2 This is the first time that we have introduced our consumer outcomes. We are developing a full range of metrics to measure progress. So these are not intended to be firm conclusions, but rather initial impressions of progress and tentative conclusions based on the findings of our thematic and other supervisory work. We will use these findings to help shape our forward programme of work (see Chapter 6).

4.3 We also include references to material from our financial capability baseline survey which provides an insight into the challenges we – and firms – face in delivering each of the outcomes.

4.4 In our July 2005 paper 'Treating customers fairly – building on progress' we indicated that we would do further work on TCF issues in the mortgage and general insurance sectors. Full cluster reports are available on our website[12] and the key messages are summarised at Annex 1.

Our high level assessment

4.5 Chapter 3 showed some encouraging progress from medium and large firms with their TCF initiatives. We have also been pleased with levels of senior management commitment. However, the results of our thematic and other work imply that there is some way to go before senior management commitment and the work invested in the TCF initiative overall reaches the front-line of firms' activities and translates to significant improvements across the full range of outcomes for consumers.

12 Mortgage and general insurance cluster reports, July 2006. See www.fsa.gov.uk/tcf.

4.6 We have identified some recurring TCF 'threads' through the full range of our thematic and other supervisory work:

1. findings that cause us to doubt how far TCF is embedded in the **corporate culture** – as reflected in, for example, human resource policies, training and remuneration;
2. significant shortcomings in the clarity of **communication** and documentation provided to consumers before, at and after the point of sale; and
3. indicators suggesting that the overall **quality of advice** provided to consumers needs attention and that some firms are not taking steps to limit the risk of mis-selling.

4.7 In reaching our initial conclusions we note that the position is complex and varies according to the individual firm. In general, whether firms are looked at by sector or by size, there is a variety of performance. We will continue to share good practice through the reports of our thematic work, cluster reports etc.

Sources of information

4.8 The information that we have considered includes our 2005/06 TCF cluster work on quality of advice; TCF issues in the mortgage sector; and TCF issues in the general insurance sector. We have published on our website separate reports on these pieces of work, but in our analysis below we draw out some of the general messages on firms' progress. We have also analysed our other recent thematic work to see what it shows us about the outcomes consumers are experiencing.[13] Many of our product or issue-specific projects relate directly or partially to TCF. Some of these pieces of work also included mystery shopping and other consumer research. This is in turn supported by our impressions from our supervision of individual firms.

4.9 There are limits to how far the specific findings and messages can be extrapolated into an assessment of industry progress on TCF as a whole. In some cases our thematic work may have involved looking at a specialised area, an area where we believe the risks to be higher, or a relatively small sample of firms. Given that they were new to statutory regulation, we have also focused a significant proportion of our thematic efforts in the last eighteen months on looking at key risk areas in the mortgage and general insurance sectors – we therefore have a richer set of data on these sectors. Every firm is different and the results vary considerably for individual firms.

13 As part of our thematic work we look at how far firms are complying with both the relevant Principles and the more detailed supporting rules. In our analysis here we do not focus on detail or the specific rules being breached. Instead we draw out the more general TCF messages from our specific pieces of thematic work.

4.10 Despite these caveats, we believe that our thematic and other work is a good source of information on progress made. It can tell us whether the aspirations expressed by firms, and in particular senior management, translate to fair treatment of customers. And it helps us to make the shift away from looking at TCF as a 'project', and more as a core principle against which we will assess firms' progress as part of our continuing supervisory work. As the next phase of improvements to our ARROW risk assessment framework[14] begins to deliver better information on firms' risk scores and risk mitigation approaches and we begin to collect data for other TCF indicators on a systematic basis (as outlined in paragraphs 2.10 – 2.11) we will develop a more complete picture.

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture

4.11 We have emphasised that delivering TCF may require major cultural change. Whatever the management style, such change needs to be driven from the top and for all firms we expect demonstrable commitment from senior management. We accept that achieving cultural change takes time.

4.12 Based on what firms tell us (see Chapter 3) we believe that some firms may be starting to move toward developing a culture where TCF is central and which is championed by senior management. For example, in our discussions with major retail groups (as part of the 'close and continuous' supervisory approach) over the last year, we have seen increased engagement and commitment from senior management to TCF and a greater understanding that TCF is distinct from customer satisfaction and requires significant cultural change.

4.13 The development of appropriate management information, including information from mystery shopping and customer surveys, will enable firms to monitor how they are performing against the defined outcomes and to determine when they have reached the embedding phase.

We have seen some firms who are approaching TCF as part of their wider corporate strategy. In one large firm, a key part of the corporate strategy is the value the firm places on the Customer Experience. In this firm the TCF initiative is championed by the Group CEO and senior management across the Group are responsible for delivery within their business areas. The firm is developing its management information to monitor TCF and progress is reviewed at monthly board meetings. Work is progressing to communicate the firm's TCF vision to staff throughout the group and the firm has a TCF challenge group to consider customer issues and products against their broader TCF vision.

14 For more details of the changes being made to our risk-based regulatory approach see the letter sent to regulated firms, April 2006, www.fsa.gov.uk/pubs/other/letter_changes.pdf.

Another large firm has established a TCF group committee headed by the Deputy CEO with sub-committees covering the main business lines. The firm is undertaking a wide-ranging review of all aspects of the business. TCF is being built into employee performance management arrangements. The firm also has management information to identify TCF issues including employee surveys, sales information, complaints data and Financial Ombudsman Service decisions to identify potential issues. The material is reviewed by the various sub-committees and where issues of concern are found these are referred to the main committee.

4.14 Over the last year we have also seen some encouraging examples in our thematic work which suggest that firms – particularly larger firms – have put mechanisms in place to address issues identified through our thematic work. In some cases this has resulted in our follow-up work on these subjects showing evidence of improved consumer outcomes:

- Our latest round of work on mortgage disclosure documentation showed improvements, particularly among the large mortgage lenders.[15]
- Our work on self-certification mortgages found, in general, that lenders had made improvements to the way they operate their self-certification mortgage business since we issued a 'Good Practice Guide' in February 2004.[16]
- We have also seen gradual improvement in standards of financial promotions (see paragraph 4.29).

4.15 However, we have seen a mixed picture from our thematic and other work suggesting that the extent to which TCF is already embedded within all relevant aspects of firms' corporate culture – for example, training and competence, remuneration and systems and controls – varies greatly between firms.

4.16 In our quality of investment advice cluster, we found that those firms with poor **training and competence** arrangements tended to offer poorer quality of advice. Our payment protection insurance (PPI) work[17] found that the training and competence of sales staff was not adequate in around half of firms.

4.17 We have also seen examples where firms' **remuneration** arrangements do not appear to contribute to the delivery of good TCF outcomes for consumers:

- Our PPI work found that the level and structure of inducements and targets for sales staff could encourage mis-selling in some firms.

15 June 2006, for full details see www.fsa.gov.uk/pages/Library/Communication/PR/2006/064.shtml.

16 November 2005. For full details see www.fsa.gov.uk/pubs/other/selfcertmortgages.pdf.

17 November 2005. For full details see www.fsa.gov.uk/pubs/other/ppi_thematic_report.pdf.

- In our quality of investment advice cluster (see paragraph 4.33) we found evidence of commission bias in some firms.
- Our mortgage cluster (see Annex 1) found some firms where the effect of the remuneration strategy for mortgage advisers could lead sales staff to focus on volumes of business, to the exclusion of any other performance measures, potentially creating a commission-driven culture.

4.18 In relation to more general **systems and controls**, we have again seen a mixed performance in our thematic work.

- Our PPI work found that compliance monitoring was variable and in some cases very poor.
- Our work on investment, general insurance and mortgage network firms' controls over their appointed representatives (ARs) found shortcomings in areas such as the level of compliance resource in Principal firms, the quality of desk checks and field visits to check ARs' compliance, the use of computer systems for monitoring ARs, and how far networks operated a risk-based approach to the monitoring of ARs.[18]

4.19 Under the **Unfair Terms in Consumer Contracts Regulations 1999** (the UTCCR), we have seen many examples of significant deficiencies in firms' standard form consumer contracts. We see this as an example of how the general TCF agenda has failed to take hold in a specific area. This is also relevant to consumer outcomes 3, 5 and 6. Examples of the type of unfair terms we often find include:

- terms which are not 'plain and intelligible' but use technical language which consumers do not understand; and
- terms that allow firms to vary the contract unilaterally without specifying in the contract an exhaustive list of valid reasons for doing so. An exhaustive list of valid reasons is an important route to fairness if the consumer is not free to exit the contract rather than accept the variation.[19]

4.20 In our day-to-day supervision of individual medium-sized firms and major retail groups we tend to find that a high proportion of the most serious risks we identify relate to concerns about sound management of a firm (for example, corporate governance, systems and controls and compliance arrangements) and adequate financial resources. We therefore spend a significant part of our regulatory resources, particularly for medium-sized firms, in working with firms to mitigate these risks. These risks may not be closely associated with the product life-cycle or the customer-facing areas of a

18 December 2005. For full details see www.fsa.gov.uk/pages/Library/Communication/PR/2005/140.shtml and www.fsa.gov.uk/pubs/other/ar_factsheet.pdf.

19 See the Statement of Good Practice on fairness of terms in consumer contracts, May 2005, www.fsa.gov.uk/pubs/other/good_practice.pdf; Chapter 1 makes specific reference to the application of TCF to this area.

firm's activities. However, we hope that this investment will bear fruit in terms of culture – as firms tackle risks within their management and systems and controls, this should provide an improved environment for implementing a TCF initiative and delivering better outcomes for customers.

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

4.21 The second consumer outcome focuses on the need for firms to design products that are suited to their intended market, and to minimise the risk that the targeting of these products might lead those for whom they are unsuitable to buy them. This outcome is key to preventing mis-selling and mis-buying of products.

4.22 In general, we have not focused significant resources in the last year on product design and testing how far products meet customer needs. We have previously published case study material and suggested good practice on this topic,[20] and we may do further work on this to test how far the good practice is being met.

4.23 The quality of material which product providers give to distributors can play an important role in meeting this outcome.

Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale

4.24 One of our key regulatory aims in retail financial markets is to ensure that consumers have access to simple and understandable information to help them make decisions. We see clear communication as a key component of firms' approaches to TCF as well as to Principle 7 – '*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*'.

4.25 Overall, the message from successive pieces of thematic work across a range of retail sectors suggests that many firms need to communicate better. In our work across a range of sectors and sizes of firms we have found that standards in this area are disappointing, with successive pieces of our work showing high failure rates for both the provision of disclosure documentation and the adequacy of the content. However, we have also seen some encouraging signs, including efforts from firms to respond to our findings and improved results from our most recent thematic work.

20 See www.fsa.gov.uk/tcf.

4.26 Our work on **disclosure before the point of sale** has produced disappointing results in a number of sectors. For example, our past work on financial promotions has raised concerns in a number of sectors, including investment advisers,[21] general insurance[22] and mortgage firms.[23] However, after investing resources in this area, we have seen a gradual improvement in standards (see paragraph 4.29, below).

4.27 Our thematic work on **disclosure and communication at the point of sale or the advice process** has also produced some disappointing results.

- Our work on PPI found an over-reliance on product documentation given to the customer at the expense of explaining the policy to the customer orally: most firms selling by telephone did not give sufficient information on exclusions. We also found that the quality and timeliness of product and price disclosure by some firms selling single premium policies was poor.
- Our work on standards of disclosure following the depolarisation changes[24] found that in most cases financial advisers sampled were not complying with our rules on investment disclosure – advisers gave out both the Initial Disclosure Document and the Menu to customers at the right time in only 42% of cases; 65% of documents reviewed contained errors, many of which were in key sections that could make it difficult to compare and shop around.
- Our work on general insurance disclosure[25] found that 62% of Initial Disclosure Documents reviewed did not comply fully with our requirements and there were a range of issues with both policy summaries and Key Facts documents: poor quality of style and presentation; missing information; and significant and unusual exclusions either omitted or not given due prominence.

21 Our work on different types of financial promotions issued by investment advisers found that many promotions were unbalanced, emphasising the benefits without adequate disclosure of risks and other key information. Review of website advertising and Venture Capital Trusts (VCTs). May 2006. For full details see VCTs Briefing Note, www.fsa.gov.uk/pages/about/media/notes/bn002.shtml. Review of web-based VCT financial promotional material. November 2005. For full details see www.fsa.gov.uk/pages/library/communication/PR/2005/125.shtml.

22 Our work on financial promotions for general insurance products found that many products are being promoted on the basis of price alone - either pricing of premiums, or price-matching and savings claims. March 2006. For full details see www.fsa.gov.uk/pubs/newsletters/fp_bulletin5.pdf. Our work on financial promotions for Critical Illness Cover found some worrying examples, including the use of scaremongering, unsubstantiated claims, and misleading representation of the product and its features. August 2005. For full details see www.fsa.gov.uk/pubs/newsletters/fp_bulletin3.pdf.

23 Our work on financial promotions by mortgage firms and our work on promotions for sub-prime mortgages and consolidated debt found low levels of compliance with our financial promotions requirements, for example failure to disclose Annual Percentage Rates or fees and insufficient prominence given to the drawbacks of secured lending and to risk statements. For full details see www.fsa.gov.uk/pubs/newsletters/fp_bulletin2.pdf and www.fsa.gov.uk/pages/doing/regulated/promo/mgi/themes/index.shtml.

24 March 2006. For full details see www.fsa.gov.uk/pages/Library/Communication/PR/2006/031.shtml and www.fsa.gov.uk/pubs/ceo/disclosure.pdf.

25 October 2005. For full details see www.fsa.gov.uk/pubs/ceo/gi_disclosure.pdf.

- Although we have seen some improvements in our latest round of work on disclosure standards in the mortgage market (see paragraph 4.29), our early work found disappointing results. We found cases where documents were not in line with the format and content required by our rules or were too long and written in overly legalistic language. Some Key Facts documents did not contain all the required information, and some included more information than the rules require, making them longer than necessary. 80% of the firms sampled had five or more errors in connection with their Initial Disclosure Documents. Although individually the errors were not major, taken together they can undermine the purpose of the documents.[26]

- When we looked at life insurance firms' preparations for the introduction of the new disclosure document, 'Consumer Friendly Principles and Practices of Financial Management' (CFPPFM),[27] we found that some firms' documents were of a good quality. But it was clear that others needed a fairly major overhaul. For example, even though the documents are intended to cover the main subject areas in the PPFM, some failed to do so. We were also disappointed to find that some CFPPFMs were not easy to find on the providers' websites.

Our Financial Capability Baseline Survey found lower levels of financial capability among 18 to 40 year olds and the over 70s. We expect firms to produce information which customers can easily understand and which reflects the nature of the product in order to ensure they are treating customers fairly. However, with different levels of financial capability, an approach which might contribute to treating customers fairly in one context may not achieve the same outcome with another group of customers.

4.28 We have not focused significant resource on looking at **communication to customers after the point of sale** although we are, for example, doing some work on post-sale communications in the life insurance market.

4.29 In contrast, our thematic work has also produced some more positive evidence of firms working to deliver fair treatment of customers in their communications to customers:

- Our general view on financial promotions is that our decision to focus significant resources on monitoring firms' advertising and acting on issues identified has produced results. For example, we have seen a gradual improvement in the standards of investment promotions. We intend to issue an update on our work in this area shortly.

26 May 2005. For full details see www.fsa.gov.uk/pubs/ceo/results_mdd.pdf. August 2005. For full details see www.fsa.gov.uk/pages/Library/Communication/PR/2005/089.shtml and www.fsa.gov.uk/pubs/consumer-research/crpr42.pdf.

27 See Insurance Sector briefing on PPFMs, October 2005, www.fsa.gov.uk/pubs/isb_management.pdf.

- In the general insurance sector, our critical illness insurance work[28] found encouraging steps taken by firms to assist in the fair treatment of customers, for example by making policy documents and application forms for this complex product clearer.
- Our latest round of work on mortgage disclosure[29] found some issues, in particular with the Initial Disclosure Documents (IDDs) provided by intermediary firms. However, we also saw real improvements. We found that the small lenders sampled produced adequate IDDs while the larger lenders have made good progress in improving the quality of both their IDDs and Key Facts Illustrations.

Two of the major retail groups included in our work on depolarisation disclosure performed well. So we looked more closely at the arrangements they had in place. These included a large programme of mystery shopping to check the customer experience as well as follow-up customer care calls after the point of sale. These calls focused not just on customer satisfaction but also on questions of fairness, for example whether the customer had been offered disclosure documents at the right time and whether they were clear if they had been offered advice or not. This investment in systems to monitor the overall customer experience appears to have resulted in better consumer outcomes.

4.30 We have seen some improvements in information provision after the point of sale, for example in relation to mortgage endowments. But this remains an area of concern in some areas.

Our Financial Capability Baseline Survey found that, across all products, very few customers failed to read the terms and conditions at all. Clear communication with customers in the terms and conditions documents, as well as all other material produced by firms, will therefore contribute towards ensuring that firms treat their customers fairly.

Our Financial Capability Baseline Survey found that the internet is an important channel for information which informs consumer choices and acts as a channel for non-advised sales. Firms should therefore satisfy themselves that the material they publish on the internet meets the requirements of TCF.

4.31 We have been encouraged by the recent improvements seen in some of our thematic work on communications and disclosure. But firms in all sectors still need to focus on providing clear information to their customers before, at and after the point of sale.

28 May 2006. For full details see www.fsa.gov.uk/pubs/other/critical_illness.pdf.

29 June 2006. For full details see www.fsa.gov.uk/pages/Library/Communication/PR/2006/064.shtml.

Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances

4.32 Quality of advice standards vary between firms. We have seen some good examples. However we have also seen TCF failings, in particular failure to obtain significant information to test suitability of products, and failure adequately to explain risks or the implications of a particular course of action. In some cases failures in the advice-giving process can lead to mis-selling and actual consumer detriment.

4.33 A summary of our findings from the TCF cluster on the quality of investment advice processes is given below. The cluster looked at the systems and advice generating processes in place in firms providing advice on mainstream investment products. The objective was to help firms improve their advice processes and reduce the risk of mis-selling. The findings are most relevant to firms operating in the retail investment advisory market, but the work also looked at small numbers of product provider firms with direct sales forces and retail banks offering investment advice. The full cluster report, which includes examples of good and poor practice as well as a factsheet and two case studies, is available on our website.[30]

Quality of Investment Advice Processes TCF cluster findings

Our work found many examples of good TCF practice but there remain an unacceptable number of firms that fail to take the steps necessary to reduce the risk of mis-selling, both in terms of the detailed rules and the wider principles. Key findings are:

- The quality of advice is dependent on the quality of advisers. We found that the quality of advice was much better in firms which had a robust training and competence regime. Approximately one-third of firms sampled did not have adequate training and competence procedures in place.
- Over half of the firms did not overall obtain adequate 'know your customer' information before giving recommendations, including on affordability and customer needs and objectives.
- Almost all of the firms held themselves out as offering a full advice service, but only a third actually undertook a full review of clients' needs and objectives. Very few gave consideration to debt repayment.
- More than half of the firms sampled provided a poor standard of suitability letter to their customers, or no letter at all. Firms should ensure that these letters are succinct but highlight the key information the customer needs, explain why they are making a particular recommendation, give a balanced view of the product, and highlight the risks associated with it.

30 Cluster report, factsheet and case studies – TCF and Quality of Advice, July 2006. See www.fsa.gov.uk/tcf.

- On the question of customers' options on paying for advice, a significant number of mystery-shopped firms claiming to be independent did not offer customers an option of paying for advice, as required by our rules. In some cases, where fees were offered, customers were being dissuaded from taking this option.
- In approximately half the firms reviewed the quality of advice was not monitored. It was also common for firms that obtained some form of management information not to act on it. We would expect senior management to have systems in place to satisfy themselves that fair treatment of customers is being delivered throughout the firm.

4.34 The findings of various other pieces of thematic work have also given rise to concerns about the overall quality of advice provided to consumers on particular products. We have seen evidence of some firms failing to demonstrate adequately that particular products are suitable for customers. We also found more general failings in the sales and advice process in some firms.

- Our PPI work[31] found poor selling practices: there was a risk of sales to people who were unlikely to qualify under the policy; there were inadequate controls in place for non-advised sales; and advice was often likely to be poor – most firms did not have systems in place to assess suitability adequately.
- Our work last year on lifetime mortgages[32] found significant failings: more than 70% of advisers did not gather enough relevant information about their customers to assess their suitability for the product and more than 60% of the mystery shoppers reported that their adviser had not explained the downsides of equity release. In our follow-up work on lifetime mortgages we have seen some progress, but we still have concerns in some areas. We will issue our findings shortly.
- Our work on self-certification mortgages found some improvements among lenders in the way they operate this aspect of their business (see paragraph 4.14). But we found failure by brokers in 47% of cases to demonstrate they had appropriately assessed affordability. And in 36% of cases no reason was given, or the reasoning was unclear, as to why a self-certification mortgage had been recommended. We also looked at whether brokers were encouraging customers to inflate their income to obtain a larger mortgage. We found no systematic evidence of this, although a small number were prepared to discuss this with customers.

31 November 2005. For full details see www.fsa.gov.uk/pubs/ceo/ppi.pdf.

32 November 2005. See www.fsa.gov.uk/pages/Library/Communication/PR/2005/055.shtml.

- Our work on sales of sub-prime mortgages in smaller mortgage brokers[33] found that in 60% of cases insufficient information was obtained about the customer and in 80% of cases there was a lack of evidence to show how the recommended sub-prime product met the customer's needs and circumstances.
- We also have concerns about the availability of ongoing advice for with-profits policyholders. As with any long-term financial investment, with-profit policyholders need to consider at regular intervals whether their investment continues to meet their needs, and many need help with making informed decisions. Anecdotally, we had heard that few financial advisers were proactively engaging with their customers on this subject. We have commissioned some independent research to verify whether this is a real problem in the market and will give feedback on the findings in due course.[34]

4.35 We did find some more positive evidence that some firms are delivering good quality advice to their customers. For example:

- In the mortgage market, our thematic work on the selling practices, training and competence of smaller mortgage brokers[35] produced encouraging results, with 50% of firms having either no, or minor, failings and most firms operating appropriate systems and controls. Specific failings were identified in a small number of firms.
- Our PPI work[36] found that sales of regular premium PPI sold with prime mortgages are generally compliant.
- Our latest work to look at standards of advice on critical illness cover[37] was also broadly encouraging.

Our Financial Capability Baseline Survey found that most customers seek advice from sales staff, financial advisers and brokers when buying mortgages. Where customers seek advice, over half felt that the advice they were receiving was clear and many would be influenced by, or purchase, the adviser's recommendation. Firms should bear these factors in mind when considering whether their sales and advice process reflects TCF.

4.36 We will continue to focus efforts on tracking the provision of good quality advice. For example, we have recently started a review of advice processes in the mortgage market. And we may consider further work on the overall quality of the outcomes consumers experience in this context.

33 September 2005. For full details see www.fsa.gov.uk/pages/Library/Communication/PR/2005/095.shtml.

34 For more details see Insurance Sector Briefing: Update on Closed With-Profit Funds, November 2005, www.fsa.gov.uk/pubs/other/isb_wpfunds.pdf. This includes a list of questions and considerations to help consumers when thinking about what to do with their with-profits investment.

35 June 2005. For full details see www.fsa.gov.uk/pages/library/communication/PR/2005/066.shtml.

36 November 2005. For full details see www.fsa.gov.uk/pubs/ceo/ppi.pdf.

37 May 2006. For full details see www.fsa.gov.uk/pubs/other/critical_illness.pdf.

Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect

4.37 We have seen many examples where firms have failed to communicate effectively with their customers about the characteristics of the products they are buying. This has resulted in examples of mis-selling and mis-buying, including PPI, structured capital at risk products (SCARPS) and lifetime mortgages.

4.38 We continue to see poor practice in the clarity of documentation and communication with customers (see Outcome 3, above). So overall we believe that firms still need to make progress on delivering clear communication, and therefore managing their customers' expectations about the products and/or service they are buying.

A large firm argued that its high client retention rate illustrated that it treats its customers fairly. Despite this, the firm rolled out a TCF project sponsored by the Managing Director examining internal practices and looking at the views of customers. This led to a review in the charges on its products and the firm has now decided to introduce an annual TCF review of the entire product range. Customer research by the firm highlighted the need for literature to be more consumer friendly, for some areas of service delivery to be improved and for the status of advice to be made clearer.

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.

4.39 We have seen some improvements in this area. For example our claims handling work with general insurance firms was encouraging.

4.40 We have found that many firms have identified that good complaints handling can be a critical element of delivering on TCF. Our thematic work on mortgage endowments looked at the quality and speed of complaints handling in large firms. We collected data to enable us to focus on weaker performers. This has resulted in a marked improvement in the volume of complaints being dealt with in a timely way. We have also seen improvements in the quality of complaints handling in many firms. However, unacceptable weaknesses remain at some firms.

Our Financial Capability Baseline Survey found that many consumers who believed they had been sold a financial product that was clearly unsuitable for their needs did not complain. Only half of those who believed they had been victims of mis-selling took action, indicating that consumer complaints alone tell us relatively little about whether consumers believe they are receiving fair treatment.

Smaller firms

4.41 We recognised in our 2005 report 'Treating customers fairly – building on progress' that smaller firms face a different set of challenges in implementing TCF.[38] Over the past year we have looked at a range of subjects through our thematic work with smaller firms which can help us to draw some initial impressions on how far these firms are treating customers fairly and the progress that we will be looking for these firms to make in future. The population of smaller firms is very large and diverse and we are risk-based in the subjects we choose to look at. It is therefore difficult to draw as clear a conclusion on overall progress as we can for larger firms – this is particularly the case when trying to assess how far small firms have integrated the fair treatment of customers into their corporate culture – but we provide below some initial observations.

4.42 Linking the findings of our thematic work to the outcomes experienced by smaller firms' customers, our impression is that the position is similar to the more general picture on TCF. Progress is mixed, with some firms making more progress than others.

4.43 As explained in Chapter 3, we have not surveyed smaller firms to establish what stage of the TCF process they have reached. But with regard to the adoption of the fair treatment of customers as part of firms' **corporate culture**, we note that:

- Unsurprisingly, many smaller firms do not tend to approach TCF by looking at processes, carrying out gap analyses and developing a formal strategy.
- Smaller firms tend to invest less upfront on 'new initiatives' like TCF and generally have significantly fewer resources to devote to such activities.
- The shorter lines of communication inherent in small firms between management and customer-facing staff have made it easier for good practices to be implemented across the business once management have embraced TCF. In many cases, senior management *are* the customer-facing staff, or at least are much closer to them.
- Firms need to be open with customers about their fees and whether they will be receiving commission when selling particular products. As part of our quality of investment advice processes work, in a significant number of mystery shops, firms failed to give accurate information to customers on how the firm will be remunerated.

38 See 'Treating customers fairly – building on progress', July 2005, Annex 1 – TCF and smaller firms. www.fsa.gov.uk/tcf.

4.44 With regard to the provision of **clear information**:

- Our work on depolarisation disclosure found that in many cases customers were being given disclosure documentation at the appropriate time. But we found that the quality of communication was mixed. Small firms should continue to focus on satisfying themselves that the material they produce for their customers is clear, fair and not misleading.

4.45 With regard to the provision of **suitable advice**:

- During our work on quality of investment advice processes, we found many examples of good practice in smaller firms. Nearly all firms recognised that TCF applies to the advice process and that there is scope for improvement in all areas relating to the quality of advice. However, in approximately half our sample there were significant weaknesses in one or more areas of the advice process. The areas requiring most improvement included assessment of customer needs; impartiality of advisers; communication; and systems and controls.
- In the past we have suggested that the fact that smaller firms in general tend to have a long-standing customer base and a high level of knowledge about individual customers could mean that they are better equipped to deliver TCF. However, the quality of advice work suggests that a close relationship with the customer is not always a guarantee that the customer's needs are better understood or that TCF outcomes are delivered.
- For full details of the quality of investment advice processes cluster see paragraph 4.33.

4.46 With regard to **post-sale barriers**:

- Small firms are generally good at making customers aware of complaints handling procedures.
- However, approximately a quarter of firms reviewed in the course of thematic work had serious weaknesses in this area.

4.47 These messages about smaller firms' progress are broadly consistent with the threads we identified from our thematic work more generally. This suggests that TCF continues to represent a challenge to many smaller firms.

4.48 We will continue to use our thematic work with smaller firms to inform our overall view of TCF standards in this population of firms and the type of help that we make available to them.

5 Our regulatory approach to TCF

5.1 On TCF, as in other areas, we continue to use the full range of regulatory tools to tackle the issues we find in the market and to raise standards. We expect that our focus on TCF will increasingly be part of our normal supervisory activity, both thematic and firm-by-firm assessment work.

Communications and training

5.2 We set and make clear our regulatory standards, using a range of communications and other tools. We understand the particular importance of clear communication in more principles-based regulation, where firms are keen to receive feedback and learn more about good practice. So we are publishing alongside this paper the findings of our cluster work on mortgages, general insurance and quality of investment advice, and case studies on designing and selling a new product, marketing and promotion, and quality of advice. Earlier in the year, we published case studies on controls within networks, managing unexpected events, complaints handling, remuneration of staff and management, management information and closing a with-profits fund.

5.3 More generally, we continue to look for opportunities to engage with, and communicate to, the industry and other interested stakeholders on the subject of TCF. This includes regular engagement with our TCF Consultative Group.[39] We also publish relevant material on our website, in key FSA senior management speeches, and in our various sector newsletters.

5.4 We provide industry training on TCF, tailored to the requirements of different sectors and types of firms. To date we have run 39 training events which have been attended by over 750 practitioners.

39 The group comprises representatives of trade associations from a range of key industry sectors; consumer groups; FOS; the Financial Services Practitioner Panel, Smaller Businesses Practitioner Panel and Consumer Panel; and a personal finance journalist.

Supervisory activities

5.5 We monitor industry implementation of TCF – through firm-specific and thematic work. We adopt a risk-based approach to supervision – focusing our firm-specific resources on the higher-risk and higher-impact firms and our thematic resources on higher-risk sectors or issues. This maximises our effectiveness by allowing us to comment on current practice and to spread good practice.

5.6 The extent to which firms have embedded TCF throughout their operations has become a core part of our risk-assessment process (known as ARROW – Advanced Risk Responsive Operating Framework) for relationship-managed firms. Within that process, TCF will influence the 'scoring' of consumer products, business risk and controls, and in future firms can expect to find more emphasis on TCF in the risk mitigation plans which follow an ARROW risk assessment.

5.7 We will continue to measure smaller firms' progress with delivering the TCF outcomes. The ARROW framework for smaller firms involves the use of a range of information sources (for example, regulatory returns and the results of thematic work) to identify risks and areas where we need to do further work. We communicate the findings of our work to the industry, for example using web pages, the media and events such as road shows.

5.8 In order to ensure that our supervisors apply TCF consistently we have implemented an extensive training programme for all our staff. We have published some of the training materials on key risks, indicators and questions to give firms an indication of the types of issues supervisors are being encouraged to consider.[40]

5.9 Where our supervision work identifies TCF failings in a firm, we will consider the most suitable course of action. In many cases, we will agree with the firm how it intends to address the shortfalls and, where necessary, require them to give customers redress when the failings have resulted in a loss to them. Where thematic work identifies more widespread potential failings, we will communicate more broadly. This will typically be through a 'Dear CEO letter' sent from FSA senior management to all relevant CEOs setting out our concerns and any action required on a particular subject or issue. We then expect senior management to take action where necessary.

5.10 We provide here some examples from our supervisory work with individual firms and some examples of our approach to the results of thematic work. These cover a range of encouraging and less-good TCF practice cases and explain the supervisory approach we used in each situation.

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40 For examples of Key Risks, Indicators and Questions, see www.fsa.gov.uk/tcf.

We visited a firm to assess its systems for monitoring its selling practices. The objective was to ascertain whether the firm had effective controls in place to prevent customers being sold unsuitable products. The firm volunteered to review its procedures to address the problems we identified and consider whether a wider review of historic sales was needed.

As a result, the firm made substantial changes to its procedures and decided to review around 15,000 sales to assess whether – and how much – compensation it should pay to affected customers. The process to review sales is now under way, and we expect that compensation paid will be significant.

We had concerns about how a firm was dealing with customer complaints. As a result of the concerns raised the supervision team undertook a comprehensive review of the firm's procedures in this area and concluded that there were no material issues.

From the discussions in relation to TCF issues the firm realised they could be more proactive in communicating with their customers, and obtaining feedback. We regard this response of continuous improvement positively.

During an ARROW visit, senior management of a firm held the misconception that TCF was naturally embedded within the firm, saying: 'We always treat our customers fairly'. They admitted giving TCF some thought but had difficulty in determining the approach they should take and what was required of them.

We referred the firm to information on the FSA website and suggested examples of two areas which they might look at from a TCF perspective, in this case new products and the overall customer experience during the sales process.

Before the visit ended, the compliance director produced a mock action plan, based on previous discussions with senior management, to check their understanding. Senior management have since considered TCF in their strategy and plans and carried out a 'gap analysis'. The firm is well on the way to implementing its plans and having a confident approach to TCF.

The firm was also advised to, and has attended, one of our TCF industry training workshops.

We found a number of issues in a firm in relation to the quality of the sales processes and standards of communication with customers. As a consequence we raised concerns with the firm about a variety of sales issues including the training of advisers and monitoring of sales quality and required them to consider these issues as part of a planned review of sales guidelines and support.

A firm was slow to consider TCF until its supervisor suggested that it might be helpful to undertake a gap analysis. The gap analysis revealed weaknesses in management information and poor understanding of products on the part of customers. As a consequence the firm identified practices which would address these weaknesses and is rolling out a TCF project as a major initiative across the firm.

Earlier this year we carried out some thematic work to look at compliance with the disclosure rules associated with depolarisation.[41] We acknowledged the efforts of firms to produce disclosure documentation and we did see some good examples. But overall we were disappointed with the results and found that most financial advisers were not complying with our rules on investment disclosure. We issued a 'Dear CEO' letter in March to communicate our findings. We asked firms to review their documentation and procedures to consider any changes needed.

When we undertook our thematic work on claims-handling in the general insurance market we saw positive signs that firms are starting to implement TCF initiatives into their processes and procedures. We encouraged the industry to continue to make efforts to apply good practice standards, particularly in their liaison with customers, complaint-handling arrangements and managing relationships with outsourced providers.

For with-profits business, there are particular TCF issues as a result of the degree of management discretion that is exercised in managing the business and determining the level of payouts to policyholders. Where firms propose to take management actions in respect of their with-profits business, we consider the TCF aspects of these actions and raise objections if we consider them to be unfair. Our consideration of such actions involves detailed discussions between firms and our supervisors and sometimes results in firms changing their proposed actions.[42]

5.11 As part of our next phase of work on TCF we will target resources to deal with those firms which are slow to grasp TCF and take any appropriate action.

Dealing with failure

5.12 Finally, where necessary, we take enforcement action for material TCF failings in firms.

41 March 2005. For full details see www.fsa.gov.uk/pubs/ceo/disclosure.pdf.

42 Further details of our process for considering management actions are set out in our publication entitled 'FSA supervision of closed with-profits funds and process for considering management actions by with-profits firms', May 2005, www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2005/wp_supervision.shtml

5.13 In line with our risk-based approach to regulation, and because enforcement is not always the best tool to use, we do not expect to take enforcement action every time we think there has been a breach of Principle 6 or other relevant principles. We are less likely to take enforcement action where the firm has considered the implications of TCF for its business, where senior management have played the role we expect of them in relation to TCF, where a firm has made a genuine attempt to deliver on what TCF means for it, and where there has not been significant actual – or risk of – consumer detriment. Conversely, we are more likely to take enforcement action in cases where a firm has not responded to indications that there are problems, has failed to identify shortcomings and to develop a strategy to deal with them, where there has been a serious breach of Principle 6 or other relevant principles, or where there has been significant actual or potential consumer detriment.

5.14 We already often take enforcement action for breaches of detailed rules related to Principles relevant to TCF. The move to more principles-based regulation will mean a higher incidence of cases of two kinds:

- Cases where a breach of a Principle is considered alongside a breach of detailed rules: where relevant, a breach of the relevant Principles will be cited as well as breaches of specific rules.

Our most recent enforcement action involving breaches of Principle 6, other principles and detailed rules was against Guardian Assurance PLC. We found systemic flaws in Guardian's mortgage endowment complaints handling procedures. This meant that Guardian was failing to treat customers fairly by failing to handle customer complaints appropriately, exposing a large number of customers to the risk of financial loss.[42]

In this case Guardian was fined for breaches of Principles 2, 6 and 11 as well as breaches of our dispute resolution rules and our supervision rules.

- Cases taken on breach of Principle alone: our regulatory principles are FSA rules and we can and do take action on the basis of breaches of principles alone, whether or not there has also been a breach of other rules. We expect to do this more in future – so covering areas of importance to TCF where detailed rules do not exist.

5.15 In addition, we will increasingly consider cases where the firm fails to engage with TCF. For the minority of firms lagging behind in their TCF work, we have set a target – we expect all firms to have reached at least the 'implementing' stage of their TCF work in a substantial part of their business by the end of March 2007. We will have less patience with those firms that continue to deny (incorrectly) that TCF has any relevance for them, or have failed to take appropriate steps to work out what changes may be required.

42 January 2006. For full details see www.fsa.gov.uk/pubs/final/guardian.pdf.

Where we find that this is the case, and after appropriate warnings, we will be more inclined to instigate enforcement action if we find that the resulting systems or actions of a firm have caused – or leave open the potential for – consumer detriment.

5.16 We expect senior management to take responsibility for ensuring that their firms treat their customers fairly, including identifying risks, having appropriate systems and controls in place to mitigate these risks, and ensuring these are effective. Where we detect a breach which requires enforcement action we will consider taking action against individuals within the firm if we consider that senior management have failed in their responsibilities.

6 What we will do next

6.1 For our next phase of work, we intend to facilitate and oversee further progress by firms. In those firms which are further advanced with their initiatives we will look to ensure that the commitment of senior management translates to delivery of real outcomes for consumers. In those firms which are behind their peers, we expect to see significant progress.

Facilitating progress

6.2 To facilitate progress, we will consider cluster work on new or continuing risks emerging from our analysis (see Chapter 4) of the current position against the consumer outcomes.

(1) On **delivering cultural change** in firms we intend to look at some of the organisational and management arrangements that may encourage or inhibit the move from senior management commitment to the consistent delivery of fair treatment of customers in all parts of a firm's business. This may include considering:

- remuneration and other incentives – including the arrangements for senior management – and the nature of any link between such arrangements and the outcomes for consumers; and
- training, to establish good and poor practice in implementing effective arrangements, particularly in the light of the quality of advice work, which highlighted a link between training and the quality of the consumer outcome.

(2) We will also consider **how products are targeted to meet the needs of specific groups of consumers**. We have undertaken an analysis of the responsibilities of providers and distributors of financial services products for the retail market. We believe that providers play an important role in designing and targeting products; in providing clear communications to those firms which sell retail products to consumers; and in post-sale service where

they acquire a continuing contractual relationship. Distributors for their part will generally be responsible for the sale itself including information provided, or for the suitability of any advice. We anticipate sharing this analysis in due course and we may carry out work to explore further how far these responsibilities are being met in practice.

(3) We will continue to focus efforts on the **provision of good quality advice**. For example, we have recently started a review of advice standards in the mortgage market. And we may consider further work on the overall quality of the outcomes consumers experience in this context.

Good and poor practice

6.3 We are considering, with help from our TCF Consultative Group, how to develop further case study material for firms to use when considering what TCF means for them. Feedback on the materials we have published to date has been positive, both on the case studies themselves and on the good practice examples. We expect to publish more of this sort of material in the future, focusing on those areas which the Consultative Group tell us would be most helpful.

6.4 We will also describe to the firms involved in a piece of thematic work the nature of any link with TCF. Our thematic work will include reporting on good and poor practice we have seen, as well as more analysis and reporting of common threads.

Monitoring progress

6.5 For the minority of firms lagging behind in their TCF work, we have set a target – we expect all firms to have reached at least the 'implementing' stage of their TCF work in a substantial part of their business by the end of March 2007. We are keen that firms maintain the momentum towards delivery of fair outcomes. So we will consider ways in which we might sustain that momentum, potentially by setting further deadlines.

6.6 We reported in Chapter 3 firms' self assessment of their progress on TCF. In our next phase of work, we will review this. We will look at how far firms' own assessment of their progress matches our view of what implementing and embedding mean. And we will look at whether firms have management information to demonstrate the delivery of fair outcomes for consumers. Our discussions with firms will also help them to understand where their progress on TCF fits with that of their peer group. Some of the areas we may focus on are senior management engagement; the quality of any gap analysis carried out by the firm; the adequacy of plans to address any identified gaps; and the approach to monitoring, evaluating and reinforcing TCF.

6.7 We will also be pressing those firms which have yet to move beyond the 'Aware' and 'Strategy and Planning' phases of their TCF initiative to start to implement any priority changes they have identified as being required, so that a substantial part of their business can be placed in the 'Implementing' phase by the end of March 2007.

6.8 We are developing our approach to dealing with those firms – particularly medium-sized firms – which are making slower progress with their TCF initiatives. We will first ensure that we have identified these firms and then try to understand more about the problems they are finding with developing their approach to TCF. We will then consider how best to help them tackle these problems. This may include using targeted communications; dedicated visits to review gap analyses and challenge management; and, if necessary, the use of further investigative tools.

6.9 Alongside firms' own assessment of progress (through use of management information), we will put in place a range of metrics to determine a more complete picture of progress being made against the six consumer outcomes.

Further communications and training from the FSA

6.10 We are planning a sustained programme of communications about TCF in the coming months and expect, as last year, to hold a conference for firms towards the end of the year. We will produce a user's guide to this report for smaller firms, and will provide tools and updates on good practice to help them, such as the self assessment tool we published earlier this year to highlight some of the TCF issues small firms should consider.[43]

6.11 Our Industry Training on TCF has been well-received and this will continue to be available.

6.12 As part of our work on consumer capability, we are adopting a more strategic approach to our consumer communications, and we will provide consumer information and services in a more accessible and engaging way. In particular, we are redeveloping our consumer website and will promote more effectively the information and services that it provides. These materials will take account of areas where we believe there are risks to the fair treatment of consumers, both in terms of specific products (where we provide information on how they work) and other types of risk.

43 Treating Customers Fairly Self Assessment Tool, see www.fsa.gov.uk/pages/Doing/small_firms/general/docs/tcf_tool.pdf.

Developing consistent TCF messages from the FSA

6.13 We recognise that a more principles-based approach requires our staff to become more experienced and confident in making informed, sensible and outcome-focused judgements and decisions, often where there is some ambiguity in the specific detail of the issues at hand. We also recognise the importance of ensuring a consistent and proportionate approach to reviewing progress on TCF. Although we have made some progress, feedback from firms and trade associations suggests that we still have further to go before we have succeeded.

6.14 Our thematic and cluster work is designed with this in mind, allowing a side-by-side comparison of firms' performance in a particular area. We seek to ensure consistency in the outcome of firm-specific supervisory work through a number of tools, including peer group reviews, management oversight and internal challenge at ARROW review panels.

6.15 It is our intention that TCF becomes 'business as usual' for our supervisors, in their assessment of firms and in their dialogue with senior management and Boards of Directors. We are taking measures to adapt our supervisory approach, and to provide our staff with further support for their work on TCF. For example we have conducted a significant amount of internal training on TCF. We have a central TCF team that initiates and drives our work and will provide further support to supervisors. TCF is also an important element in our new ARROW framework for risk-based regulation and the training that goes with this. We plan to continue and expand our work in these areas.

6.16 We will continue discussions with trade associations about their role in delivering more principles-based regulation and how we can maximise the potential use of industry codes and industry-developed 'Good Practice Guides'. And we will continue to involve our other stakeholders, including the members of our TCF Consultative Group.

TCF progress in the mortgage and general insurance sectors

In our July 2005 paper 'Treating customers fairly – building on progress' we indicated that we would do further work on TCF issues in the mortgage and general insurance sectors. Full cluster reports are available on our website[44] and the key messages are summarised below.

Mortgages TCF cluster findings

Our work in the mortgage market found encouraging signs that some firms are making progress in implementing TCF. Equally, other firms are having some difficulty in working out what TCF means for them and how to approach it.

Firms do need to understand the importance of TCF and we encourage a focus in three areas:

- Product design – Considering how to treat customers fairly when designing new products will produce TCF gains in all other stages of the product life-cycle. Firms and their customers benefit from firms considering a range of issues as part of the design process. These issues include the marketing strategy, developing product literature and effective administration systems and controls, and considering the training implications and information needs of all involved in distributing the product. While some firms consider and address some of these areas, few seem to cover all.

- Clarity of disclosure – it is important that firms consider whether their product literature is capable of delivering customer understanding. Product literature is the information customers will rely on at the point of sale and it is important that customers can compare products and understand features, and are aware of those relevant to their position. The Mortgage Conduct of Business (MCOB) rules are designed to deliver this to customers, and the compliance of firms with these requirements is a key step towards delivering TCF.

44 Mortgage and general insurance cluster reports, July 2006. See www.fsa.gov.uk/tcf.

- Remuneration strategy for advisers – Firms should design their remuneration strategy to reflect the TCF principle and so that commission rates do not result in sales bias. We have come across some firms where the effect of the remuneration strategy could lead sales staff to focus on the volume of business done to the exclusion of any other performance measures, potentially creating a commission driven culture.

General Insurance TCF cluster findings

Our discussions with firms and trade bodies active in the general insurance sector suggest that some firms recognise the need to treat customers fairly. However, many other firms have yet to engage actively with it. Some firms have said they rely on strong price competition in some sectors of the general insurance market in delivering TCF. Others have told us that they measure TCF in terms of customer satisfaction.

However, a customer may be happy with the price or service they have received but not have been treated fairly (for example, if sold a product on which they may be unable to claim). Equally, some customers may not always be satisfied (for example, if a claim is rejected) but may have been treated fairly. While price competition and customer satisfaction can have some role to play in improving the way customers are treated, they are not sufficient, in themselves, to achieve TCF.

We agree that good practice should be easier to achieve for more straightforward and highly competitive products such as motor and household insurance. However, it is also clear that more complex product types such as critical illness and payment protection insurance pose a significant challenge to the fair treatment of customers.

As with other types of firm, general insurance firms need to consider those elements of the product life-cycle that apply to them and ensure they have considered whether they are treating their customers fairly at all these stages.

Our cluster work found some good practice:

- Claims handling – we found that most firms are handling claims well and saw encouraging signs that firms are building TCF into their processes; we encourage all firms to continue to make efforts to embed good practice, for example ensuring that customers have sufficient information about the process and that any conflicts are managed. Using outsourcers for claims handling puts greater emphasis on the need for firms to ensure that their approach to claims handling does treat customers fairly.

But much progress remains to be made, particularly in:

- Product design – Firms need to design general insurance products that fit the needs of the target audience. When designing products firms also need to consider marketing and distribution and ensure that the product is developed with all of this clearly in mind.
- Clarity of disclosure – this is key both for financial promotions and for information provided to customers at the point of sale. The distribution method for each product is relevant and firms should carefully consider how to get the key information across to customers. Providing customers with a means and opportunity to discuss queries should aid customer understanding, particularly of complex products.
- Systems and controls – general insurance firms should ensure that they collect management information on all aspects of their general insurance business and that this information is reviewed by senior management and used throughout the product life-cycle, for example at the product design, marketing and distribution stages. It should also be an important input to the areas of remuneration and training.

FSA website material on TCF

Our website at www.fsa.gov.uk/tcf carries our published material. There is also feedback on our supervisory work, including reports on this year's clusters:

- Management Information;
- Quality of Advice;
- Mortgages; and
- General Insurance.

These complement last year's clusters on product design; management information; remuneration; strategic change; complaints management; interfaces between providers and distributors; progress in implementing TCF among large firms; and progress in implementing TCF in some medium and smaller firms.

The website also carries a number of case studies designed to assist firms in considering what they need to do in various scenarios. We have now published further case studies:

- Quality of Advice;
- Designing and selling a new product; and
- Marketing and promotion.

These add to our earlier case studies on product design; managing strategic change; controls within networks; complaints handling; managing conflicts of interest; managing unexpected events; information after the point of sale; remuneration; and management information.

The website also carries our previous publications 'Treating customers fairly – building on progress', July 2005; 'Treating customers fairly – progress and next steps', July 2004; 'Treating customers fairly progress report', June 2002; 'Treating customers fairly after the point of sale', June 2001. We have also published consumer research 'Treating customers fairly: the consumers' view', June 2005.

We have also published 'Key risks, indicators and questions' to illustrate some of the TCF issues which supervisors consider in their training and a Self Assessment tool specifically designed to help small firms assess whether they are treating their customers fairly.

Trade association TCF initiatives

We welcome the efforts made by trade associations to foster TCF understanding and good practice in their own sectors. The list below highlights some of the recent initiatives undertaken by the organisations represented on our Consultative Group. The list is not intended to be comprehensive. Further information about wider TCF activities can be obtained directly from the trade associations.

Association of British Insurers (ABI)

- Rolling out new Customer Impact initiative – entails board commitments to customers; an annual survey of the customer experience; and production of good practice guides to assist firms.
- Pursuing specific work on health, critical illness, lifetime mortgages and payment protection insurance (PPI) to develop best practice and consumer guides. Further work with general insurance firms on product design and management information.
- Working with BIBA and AIFA to develop guidance on provider/distributor responsibilities.

Association of Independent Financial Advisers (AIFA)

- Working with ABI to develop guidance on provider/distributor responsibilities.
- Producing TCF factsheets.
- Taking forward specific work on advising on lifetime mortgages, Pension Term Assurance, PPI and with-profits funds, including production of Good Practice notes.

Association of Mortgage Intermediaries (AMI)

- Producing TCF factsheets for members and undertaking research to explore how members are reacting to TCF.
- Working on provider/distributor responsibilities guidance in the mortgage sector.
- Holding regular briefings of Board, Working Groups and regional conferences on TCF issues.

Association of Private Client Investment Managers and Stockbrokers (APCIMS)

- Producing a number of papers considering TCF from the private client investment manager perspective. The subjects covered include remuneration, risk, suitability requirements, and TCF from a service provider's perspective.
- Running a series of events for members.
- Pursuing further work to assist member firms in explaining to clients what they can do to enhance their position regarding their investments and their relationships with firms.

British Bankers' Association (BBA)

- Working with other trade associations to develop good practice procedures and customer guidance for Payment Protection Insurance.
- Prioritising the challenges posed to firms in gathering TCF management information. The BBA is currently assisting members in their consideration of core metrics to measure how far firms are meeting the FSA's consumer outcomes.
- Working with the Financial Ombudsman Service to improve complaints handling procedures.

British Insurance Brokers Association (BIBA)

- Adapting the FSA smaller firms self assessment tool for specific use by insurance intermediaries. Updating regularly the BIBA compliance manual to reflect TCF.
- Running a number of training events on TCF. TCF is a key theme at all compliance focused member events.
- Updating 'brokerAssess', the training and competence online assessment tool, to include a specific module on TCF. Working with ABI to develop guidance on provider/distributor relationships.

Building Societies Association (BSA)

- Establishing a TCF working group consisting of member firms.
- Issuing a TCF manual to inform members about TCF.
- Holding a number of seminars and workshops for members.

Council of Mortgage Lenders (CML)

- Running a series of workshops of various kinds for members.
- Including TCF as a feature in Regulation Discussion Groups.
- Maintaining a dedicated TCF page on the website.

Finance & Leasing Association (FLA)

- Working with trade associations on issues connected with PPI.
- Updating codes of practice to, among other things, reflect TCF.
- Developing training principles in connection with PPI, consistent with TCF, to raise competencies throughout the sector.

Investment Management Association (IMA)

- Running a series of workshops and seminars for members to identify good practice with output available to all members for reference. Holding regular discussions at the IMA Board and at relevant Committees.
- Producing a paper on IMA's position on the split of responsibilities between the product provider and the distributor.
- Taking forward work to identify an improved method of explaining risk to investors.

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