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

Fiduciary Duty

Consumer Panel Position Paper

1. Panel position

1.1 The Government is consulting on reforming the regulation of financial services. A Bill was introduced into Parliament in January 2012.

1.2 A stated aim of the Government is to enhance consumer protection standards. The Consumer Panel proposes that this should be achieved by including a principle in the Bill that requires firms to have a duty of care to their customers based on the common law Fiduciary Duty. This would complement the existing provision which requires consumers to take responsibility for their decisions and help overcome the failure of the existing regulatory approach to adequately protect consumers' interests.

1.3 The concept of a Fiduciary Duty covers relationships where one person acts on behalf of or for the benefit of another with a discretion or power which affects the interests of the other. The key elements are:

- no conflict of interest;
- no profit at expense of the customer without their knowledge and consent;
- undivided loyalty to the customer; and
- a duty of confidentiality – not taking advantage of information gained from the customer.

2. Benefits of incorporating a Fiduciary Duty in the Bill

2.1 Stronger consumer protection

A Fiduciary Duty would help deliver a stronger level of consumer protection by obliging firms to have a duty of care towards their customers and to avoid conflicts of interest which may be detrimental to them. This goes beyond the existing regulatory protections afforded to consumers and counterbalances more effectively the general principle that consumers should take responsibility for their decisions.

2.2 More trust in firms

It would be to the advantage of firms to recognise their fiduciary responsibilities to their customers. This would help re-establish the mutual trust that is needed if the industry is to serve society and consumers feel confident to save for the future.

2.3 A flexible regulatory regime

A Fiduciary Duty is a flexible concept, allowing the new Financial Conduct Authority (FCA) to tailor the regulatory approach to reflect the business being undertaken. We also propose that the Bill should give the FCA flexibility to apply the Fiduciary Duty '*where appropriate*'.

3. Background

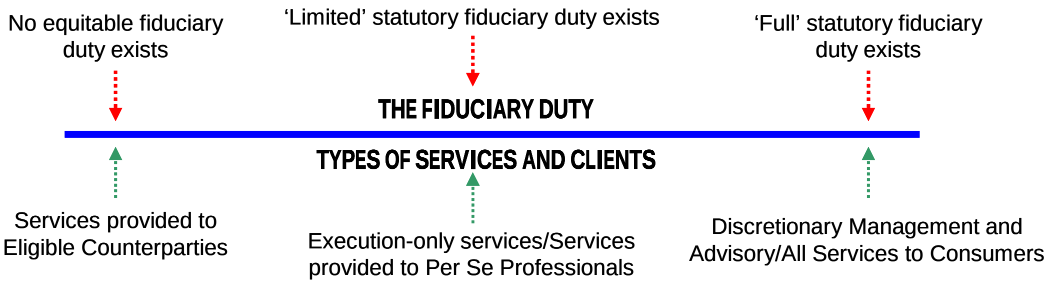
What is a Fiduciary Duty?

3.1 The concept of Fiduciary Duty derives from common law and requires firms to have a duty of care to their customers. Some existing legislation incorporates concepts of a duty of care, but this does not extend to that regulating financial services. However, the recently enacted US financial services legislation authorises the US regulator to make rules which apply the fiduciary standard to firms and consultations on implementation are underway.

3.2 The existing regulator, the Financial Services Authority, has adopted a similar approach through the Retail Distribution Review (RDR). These reforms will help ensure the interests of financial advisers are aligned with the best interests of their customers. We believe the principle of a Fiduciary Duty should be extended to other relationships between providers of financial services and their customers.

3.3 As Figure 1 shows, a Fiduciary Duty is a flexible concept. By including a broad fiduciary principle in the Financial Services Bill, the FCA would have flexibility, through their express rule-making powers, to determine how and when a Fiduciary Duty applies to authorised firms undertaking different forms of business.

Figure 1 – The sliding scale of Fiduciary Duties



Source: Norton Rose LLP

Why incorporate a Fiduciary Duty of Care in the Bill?

3.4 The draft Bill includes a principle that requires consumers to take responsibility for their decisions. This is carried over from the current legislation and is based on traditional notions of contract law, such as the principle of buyer beware or 'caveat emptor'.

3.5 The Panel has concerns about the principle of consumer responsibility; its meaning in practice is unclear; there are no legal obligations placed on consumers other than to act honestly; and when episodes of mis-selling have arisen, the starting point is misjudgement by the firms around the ability of consumers to understand the product and take responsibility for the purchase decision.

3.6 To complement the consumer responsibility principle, the Panel believes a further regulatory principle should be included within the Bill concerning how firms treat their customers: a Fiduciary Duty. This would go beyond the requirement in the current draft Financial Services Bill which requires the FCA *to have regard to the general principle that those providing regulated financial services should provide a level of care appropriate to the consumer involved or transaction being undertaken*. We believe this proposed duty fails to tackle fundamental consumer protection issues, such as the conflicts of interest of those retailing financial services. A Fiduciary Duty would ensure firms have their customers' interest at heart, which is, in itself, in the long term interests of the business and would help rebuild consumer trust in the financial services industry.

3.7 Requiring providers of financial services to have a duty of care towards their customers would complement and enhance the existing regulatory approach adopted through the FSA's Treating Customers Fairly (TCF) initiative. This initiative requires a firm to *'pay due regard to the interests of its customers and treat them fairly'*. However, on its own, this has failed to tackle a number of market problems which has led to poor consumer outcomes as shown by the recent PPI mis-selling scandal.

3.8 Firms have been fulfilling their TCF obligations by providing consumers with increasing volumes of disclosure documentation which, in many cases, is incomprehensible. A Fiduciary Duty would build on the TCF requirements by correcting failures in the existing regulatory approach and preventing firms from discharging their obligations to their customers by providing large amounts of perplexing documentation.

3.9 A Fiduciary Duty would also empower consumers to stand up for their rights against financial businesses which are serving them poorly. This is particularly important as wider protection mechanisms do not always serve consumers well. For example, pre-printed contracts, which are typically used by financial services firms, generally do not allow consumers to negotiate the terms of an agreement.

4. Conclusion

4.1 The revision of the Financial Services Bill creates a unique opportunity to create a strong regulatory framework that protects consumers' interests.

4.2 The Panel believes that requiring financial firms to have a duty of care towards their customers would help prevent a repeat of past regulatory failures, which has left consumers vulnerable to widespread mis-selling. This should be achieved by incorporating a Fiduciary Duty in the Financial Services Bill.

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