

Consumer & Retail Policy
Financial Conduct Authority
12 Endeavour Square
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4 February 2022

AFM Response to FCA consultation CP21/36, a new Consumer Duty

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
 - Comment on the proposals, and their consequences for AFM members and their customers.

About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not for profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 30 million people in the UK and Ireland, collect annual premium income of around £25 billion, and employ nearly 30,000 staff¹.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses² and to take account of corporate diversity³.

¹ ICMIF, <https://www.icmif.org/publications/market-insights/market-insights-uk-2016> with updates from EY and AFM

² Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

³ <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

AFM comments on the proposals

4. We welcome this further consultation on the new Consumer Duty. We were overall in support of the proposals in the original consultation, and many of the areas we had misgivings about have been addressed in the revisions and further articulation of the approach. We ardently believe mutuals work in the best interests of their customers, but it is valuable to be able to calibrate the approach we take against broadly agreed definitions of good outcomes.
5. The Consumer Duty represents a significant re-assessment by the FCA on what industry needs to do to avoid harm to consumers, and to maintain proper consumer protection. The ambition is reflected in the 70-plus pages of guidance: this will take firms a significant time to assess and take appropriate action on. Combined with other initiatives that are time consuming and intrusive, this appears to be a sign of more muscular regulation, and as such needs careful implementation both by firms but also by supervisors.
6. The road to the ideal model for consumer protection is littered with good intentions. We recently undertook an exercise to explore this in insurance, as per the timeline attached to our response. In the 20-odd years since the FSA/ FCA universal approach was introduced, there has been a new and significant initiative every two or three years, each making significant new demands on industry, with limited consideration of the past. Each cost-benefit case appears to roll over benefits from the previous initiatives, giving little prospect- particularly for well-run and compliant firms- that the costs of compliance are ever balanced by benefits. A failure to measure benefits accruing has compounded this impression, and it is vital this time round that FCA does not abandon this important responsibility.
7. We have responded to the specific questions raised in the consultation below, and would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'MS' followed by a stylized flourish.

Martin Shaw
Chief Executive
Association of Financial Mutuals

Responses to questions raised in the consultation

Q1: Do you have any comments on the proposed scope of the Consumer Duty?

We are comfortable with the FCA scope. We were surprised that there was an extensive debate about scope following the original consultation, as we would anticipate that a principle-based approach offered the opportunity for firms to think expansively about the way they treat customers, and not to seek to draw boundaries.

Q2: Do you have any comments on the proposed application of the Consumer Duty through the distribution chain and on the related draft rules and non-Handbook guidance?

We agree with the FCA's approach.

Q3: Do you have any comments on the proposed application of the Consumer Duty to existing products and services, and on the related draft rules and non-Handbook guidance?

Q4: Are there any obstacles that would prevent firms from following our proposed approach to applying the Consumer Duty to existing products and services?

The consultation provides helpful reassurance that the new rules will not be applied retrospectively. However, the implication of the statement in paragraph 4.9, that action could include “greater flexibility on how customers can engage with the product or assist a customer to switch to a new product...” is that the FCA is applying a degree of retrospectivity, or at least leaving a caveat. This is particularly problematic for products that only develop value over time, or where an essential feature secures protection to a vulnerable customer, which may be lost if the customer switches to another product.

Many long-term insurance contracts are sold via intermediaries, and a challenge for a product provider in applying the cross-cutting rules, is how they achieve this where the contractual relationship rests with the broker or advisor. On the one hand, a provider may recognise the need to change terms, but be frustrated in doing so by the contractual position it has with the advisor. On the other hand, there is a risk that intermediaries use the Consumer Duty to seek to re-broke products and generate extra remuneration, where a product has been designed to deliver value over the long-term. This could undermine the provider's business model, and place the customer at added risk; in acceptance of this, in the case of pension transfers, extra protections are in place to reduce the likelihood of an adviser re-broking business.

We consider it is vital that the Financial Ombudsman Service does not circumvent the FCA's stated position on existing customers, as we have seen in the past a disregard for judging cases by the standards in place at the time, in favour of contemporary standards. This is addressed in Chapter 1 in a helpful manner, but we are surprised that the same reassurance was not applied to FCA comments in Chapter 4.

A self-imposed obstacle for the regulator is the FCA's disregard for its responsibility to take account of corporate diversity. We consider that member-owned organisations are inherently more likely to seek good customer outcomes. This is recognised in part of the FCA rulebook (for example in relation to fees), and is clearly articulated in FiSMA, but is not evident in the Consumer Duty, or other aspects of the conduct rules. For example, mutuals avoid the potential conflict of interest for a firm, between pursuing good outcomes for customers, and delivering maximum returns for shareholders. We are surprised that conflicts of interest are not considered in the consultation, as it is readily apparent from past mis-selling scandals that a duty of care to customers may, in some businesses, rank of equal or lower importance than the need to provide a return to shareholders.

Q5: Do you have any comments on the proposed Consumer Principle and the related draft rules and non-Handbook guidance?

We agree with the approach taken.

Q6: Do you agree with our proposal to disapply Principles 6 & 7 where the Consumer Duty applies?

Q7: Do you agree with our proposal to retain Handbook and non-Handbook material related to Principles 6 and 7 should remain relevant to firms considering their obligations under the Consumer Duty?

We agree.

Q8: Do you have any comments on our proposed cross-cutting rules and the related draft rules and non-Handbook guidance?

We consider that the revised rules are more practical. We can see how FCA has taken proper account of the comments received on the original consultation. Comparing what we said at the time, the revisions made would appear to reasonably address those concerns.

In particular, the commentary provides an appropriate route for firms to interpret the cross-cutting rules, and to applying them in a way which supports good outcomes: for example, as we highlighted in our original response, it is unrealistic to indicate a firm should 'take all reasonable steps to enable customers to pursue their financial objectives' if those objectives are unrealistic, unknown or beyond the

scope of a product. As chapter 6 reassures, the degree to which a firm would understand or be able to act on financial objectives will depend on, for example, whether the product is sold on an-execution only basis, or on an advisory basis.

Q9: Do you have any comments on our proposed requirements under the products and services outcome and the related draft rules and non-Handbook guidance?

We have no comments.

Q10: Do you have any comments on our proposed requirements under the price and value outcome and the related draft rules and non-Handbook guidance?

The total cost a customer pays for a product, and the value they derive, are critical factors in assessing whether the firm is focused on achieving good outcomes, and acting in the interests of its customers. It is very important that customers understand both cost and value, and are given the support in differentiating between the two. A 'cheap' insurance product may simply be one with inferior features; an expensively priced product might include features that are not valuable to the customer.

Consumers can be forgiven for assuming that price comparison sites, that rank products on cost, are also demonstrating value: this is seldom the case, and the consumer may only discover that the product excludes a valued feature when they come to make a claim. Equally, product rankings, like those offered by Defaqto, tend to explore what features are present, not whether they are relevant to the consumer, nor whether the consumer is likely to claim successfully on those features.

We recognise the importance of demonstrating fair value to all customers. AFM members take great pride in meeting the needs of all consumers, and in removing barriers to people: FCA's consultation on fees for 2022/23 recognises the social purpose fulfilled by social mutual societies. However, it is also difficult for the market to solve all questions of access and price, and it is important that certain issues are tackled by a societal approach, rather than to assume that the right product can be delivered at the right price for every consumer. The Flood Re approach recognises that the market alone cannot provide affordable insurance to people that live in areas at high risk of flooding, and we think that other aspects of deprivation of vulnerability might be tackled better in a similar way.

The consultation suggests in paragraph 8.15 that an insurance product might not provide fair value if 'there is a very low level of successful claims'. We think this betrays a misunderstanding of the nature of some products. Fair value should not be assessed by the number of claims alone, but also by the proportion of premiums received, that are returned to customers in total via claims and other benefits. For example, some insurance products are designed to address consumer needs

where there is a low incidence of likely claims, but where the impact of a claim could be catastrophic.

Critical illness and income protection products could fall into this category: the Consumer Duty should expect firms to consider whether products deliver good outcomes in totality as well as for the individual. By the same token, a retail consumer insurance product is not like a lottery ticket, where all the benefits are scooped by one individual: for this reason, AFM members are increasingly focusing on how products deliver value when the customer does not make a claim, as well as on whether the features, however valuable, are so difficult to realise that very few customers will benefit.

The read across in this outcome, and in chapter 6 of the guidance, to FCA's GI value measures puts a heavy focus on data collection. The value measures do not always point unambiguously to good value: we have previously raised concerns about the adoption of these measures for health cash plans, which provide a wide range of benefits, many of which involve prevention rather than cure. The challenge of third-party data, necessary to respond to some of FCA's data expectations, is not addressed.

We would appreciate further clarity from FCA on these issues.

Q11: Do you have any comments on our proposed requirements under the consumer understanding outcome and the related draft rules and non-Handbook guidance?

We consider that to improve customer outcomes the current guidance on what constitutes 'advice' should be reviewed; otherwise the boundaries between advice, and assisting a customer in making the right decision, remain blurred.

We recognise the changes made since the previous consultation, but consider that these proposals risk confusing consumers, and leave space for claims management companies, or the FOS, to interpret complaint guidance in a way that increases risk to firms.

Q12: Do you have any comments on our proposed requirements under the consumer support outcome and the related draft rules and non-Handbook guidance?

We agree with the approach.

Q13: Do you think the draft rules and related non-Handbook guidance do enough to ensure firms consider the diverse needs of consumers?

Q14: Do you have views on the desirability of the further potential changes outlined in paragraph 11.19?

The combination of the proposed rules on the Consumer Duty, and the existing guidance on vulnerable customers, provides a very clear expectation for firms. The two different sources need to compliment not compete, and ensure that firms can consistently interpret what is expected of them.

AFM members have taken the guidance on vulnerable customers on board, and developed a range of actions to support their customers. We consider the new requirements in this consultation are consistent, and we feel there is enough incentive and guidance to firms to ensure they can act appropriately. Dealing with the small minority of firms that do not respond should be a matter for supervisory and enforcement action, and there is little to be gained (and much to be lost) by constant calibration upwards of the standards for firms that are already acting appropriately.

Q15: Do you agree with our proposal not to attach a private right of action to any aspects of the Consumer Duty at this time?

It is right that FCA has removed the PROA from its proposals, though it is concerning that it holds out the expectation that this may return in future. In our view, the PROA was only likely to be harmful to the wider objectives of FCA, including its competition obligation.

We were very surprised that the original proposals for a PROA were not vetoed by the internal checks and processes within FCA, and we suggest it is permanently withdrawn.

Q16: Do you have any comments on our proposed implementation timetable?

The proposed implementation deadline is challenging. The review work firms will need to undertake is significant, and we know from the work many of our members have focused on, covering general insurance pricing practices, that small organisations in particular will struggle to deliver all the product review work necessary by April 2023, without more guidance and support from FCA, and without a proportionate approach.

Product producers may not be acting in isolation to meet the standards expected. Our members have reported significant and onerous demands from advisory networks in the recent past, in response to other regulatory initiatives, and this too is a heavy drain on resources.

We encourage FCA to be more active in engaging with industry over the implementation period: AFM has offered support and stressed the need for engagement with FCA on the Consumer Duty, but we have had no direct approach

from FCA. Equally, as we indicated in response to the first consultation, whilst the guidance notes provide some useful examples of what is expected in practice, the focus has been on simple situations, which offer little learning to other businesses.

Q17: Do you have any comments on our proposed approach to monitoring the Consumer Duty and the related draft rules and non-Handbook guidance?

We agree with the nature of internal monitoring firms should be undertaking. Much of the data suggestions are already incorporated into internal MI reporting, though firms will need to take a project approach to reviewing gaps in data and whether and how they can close them. They will also need to review reporting structures, to ensure that Boards get the right data on how effectively the organisation is delivering on the Consumer Duty.

We would expect FCA to provide an update on its own actions each year, to demonstrate what it is doing to ensure the Consumer Duty is implemented effectively, and to evidence that the benefits expected are realised. We would look to see an account in the annual report on this.

Q18: Do you have any comments on our proposal to amend the individual conduct rules in COCON and the related draft rule and non-Handbook guidance?

We agree with this approach, though we also think the changes should be subject to an extended implementation deadline.

Q19: Do you have any comments on our cost benefit analysis?

The CBA reinforces the scale of work that is required for firms to implement the Consumer Duty: firms will not be able to treat it as a simple extension of other conduct work. The imprecision in all the figures reveals the difficulty in quantifying the impact; to illustrate though, one of our smaller insurance protection providers has had to recruit two staff to implement the requirements of the GI pricing practices alone. The Consumer Duty is significantly more onerous, and for firms with fewer than 100 employees, the work required will cause a significant drain on their finances, and take management time away from other important obligations. This would suggest that FCA estimates of the work involved are potentially optimistic, and there is a risk that some firms will conclude it is easier to withdraw products or withdraw from certain markets as a result, which would reduce choice and increase transaction costs for consumers. This would appear to contradict the FCA's competition objective.

The real challenge for FCA and firms is to understand the degree to which incremental changes in consumer protection requirements affect the costs and priorities of the business, and provide meaningful additional benefits to customers.

We recently developed a timeline of consumer protection intervention in insurance, as attached, which reinforces that the nature of intervention has been iterative. But it also reinforces that regulators have constantly sought a panacea, and in so doing having caused industry significant extra costs, only to conclude a short time later that they had backed the wrong solution, or that more intervention is necessary.

We think this might be avoided if FCA was properly held to account for how well it articulates the Consumer Duty, how clearly it sets out what firms are expected to do, how effectively it monitors implementation, and to what extent post-implementation review demonstrates that the approach is validated, and that tangible consumer benefits are delivered. We would like to see a clear commitment from FCA to this effect.

Q20: Do you have any other comments on the draft

Q21: Can you suggest any other examples you consider would be useful to include in the draft non-Handbook guidance?

We appreciate the wider range of examples provided in the guidance compared to the original, and consider these will support firms in their implementation work.

How consumer protection in insurance has evolved over time (Draft, January 2022)

The following bullet points give a (non-exhaustive) list of where regulation and legislation has given particular focus to policyholder protection over time. The notes are intended to support AFM members in recognising both the evolution of standards, and the need to constantly appraise how actions today might be assessed in the future.

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| <p>Insurance contracts have always been used to set out what a policyholder should expect from their insurance provider, and the nature and content of contracts has evolved over time via a combination of legislation, regulation and case law. In the case of a mutual insurer, the contract may, and will often, overlap with the rules or constitution of the insurer.</p> |
| <p>Policyholders' Reasonable Expectations were first established in insurance law in 1973, in relation to with-profits life insurance. PRE was described as influencing the fair treatment of policyholders, and to codifying the practices of the business, and the approach to entitling customers to a fair share of the profits.</p> |
| <p>Oversight of the financial services industry prior to 2001 was undertaken by a range of different bodies, including the Department of Trade, the Friendly Societies Commission, the Securities and Investment Board and the General Insurance Standards Council.</p> |
| <p>The notion of Treating Customers Fairly first appeared in rules made under FSMA 2000. At around the same time, a series of court cases brought significant developments in PRE (e.g. Equitable Life, 1999, and Axa, 2000), which indicated that the actuarial interpretation of PRE had diverged over time. TCF was built into FSA/ FCA rules in <i>principle for business 6</i>.</p> |
| <p>The insurance industry response to TCF and new regulatory focus, was to develop the Raising Standards self-regulatory scheme, to define best practice and to demonstrate the commitment of the sector to high standards and external assessment.</p> |
| <p>Where FSMA secured the creation of the Financial Services Authority, which gained its powers on 1 December 2001, it also led to the creation of the Financial Ombudsman Service and Financial Services Compensation Scheme. Together with the enforcement powers gained by FSA, the new regulatory bodies collectively brought a sea change in consumer protection.</p> |

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| <p>Alongside TCF, the Sandler Review in 2001 sought to introduce a range of stakeholder products, with defined terms and charges, to simplify product design and increase transparency. Much of the original concepts remain in regulatory rules today. The Retail Distribution Review, in 2006, similarly sought to provide greater clarity around costs and fees. Also, in 2007, the COBS and ICOBS sourcebooks were introduced (to replace COB and iCOB rulebooks).</p> |
| <p>In 2004, FSA introduced the Principles and Practices for Financial Management (PPFM) for with-profits products, and two years later required the production of a shorter Consumer-Friendly PPFM.</p> |
| <p>Conduct Regulation evolved from TCF, with a closer focus on both behaviours and outcomes. The creation of the FCA, in 2013, brought a sharper focus on conduct, though the concept arguably came out of an EU study of the 2008/9 financial crisis. Conduct regulation encompasses consumer regulation, corporate governance, fit and proper standards and product governance.</p> |
| <p>FCA first developed a focus on vulnerable customers in 2015, initially to develop a common understanding of vulnerability, before going on to test the levels of vulnerable customers in the UK, via research, and to introduce an 'Approach to Consumers' to set out a vision for well-functioning markets in 2018. Consultations in 2019 and 2020 lead to finalised guidance on vulnerability in February 2021.</p> |
| <p>The Insurance Distribution Directive was fully implemented in 2018, and adding extra protections for consumers buying insurance, and new expectations for firms on product governance and oversight.</p> |
| <p>The Senior Managers and Certification Regime (SMCR) replaced the approved persons regime in 2019, with the intention of strengthening market integrity and reducing harm to consumers. The SMCR is designed as a catalyst for a healthier culture, and more effective governance, by increasing accountability and establishing higher standards of conduct.</p> |
| <p>As part of its review of the GI market, FCA introduced GI value measures reporting in 2021, to tackle poor product value and harm to consumers through ineffective competition.</p> |
| <p>FCA's Consumer Duty initiative follows on from the previous consumer protection regulation, and aims to set 'higher expectations for the standard of care that firms provide to consumers'. In addition to past themes on behaviours and outcomes, the Consumer Duty adds an explicit focus on culture. The new rules apply from July 2022, and aim to deliver a more consistent standard of consumer protection.</p> |
| <p>FCA published an overview of its 2021 consumer protection work; see here.</p> |