



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

19 July 2021

AFM Response to consultation CP21/13, 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 for a new Consumer Duty; and
 - Highlight some of the issues and consequences that will need to be developed further.

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 £19.6 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>

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 summary of comments on the proposals

4. We welcome the opportunity for further engagement on the Consumer Duty. When the proposal was first put forward in 2018, it was unclear how the concept would add significantly to the pre-existing FCA principles and rules. It is encouraging therefore that the consultation expands on FCA's thinking and makes a more compelling case.
5. The now-published FCA Business Plan indicated the Consumer Duty is a central ambition to the regulator in 2021/22. The consultation has been a considerable time in development, and the absence of detailed rules and a cost-benefit case shows that the deeper thinking is still incomplete. We encourage FCA to take sufficient time and energy to work through the consequences carefully and fully, including the consequences for other parts of the rulebook.
6. We consider some aspects of the proposals will have significant effect on the way many firms approach the development of products and services, and the way they treat customers. On the whole, this should be beneficial, in supporting the need for firms to work to achieve good customer outcomes, but only where the costs of complying are proportionate to the benefits.
7. In our view, the Outcome which is focused on price and value covers ground that is less explored than other aspects of the Consumer Duty. We have a concern that the Private Right of Action risks undermining the broader benefits, by raising the costs significantly to consumers and firms, and by distorting the supply of products. Our favourable view on the Consumer Duty is conditional on the PROA being removed.
8. 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', with a long horizontal stroke extending to the right.

Martin Shaw
Chief Executive
Association of Financial Mutuals

Our responses to specific questions raised in the consultation

Q1: What are your views on the consumer harms that the Consumer Duty would seek to address, and/or the wider context in which it is proposed?

We agree that a key audience for the Consumer Duty is vulnerable customers. When dealing with insurance claims, we encourage our members to assume all claimants are potentially vulnerable- implied by the need to make a claim. By extension therefore, the merits of a Consumer Duty are consistent with expectations of how firms treat all their current customers.

It also implies the same duty towards prospective customers, and we agree with this: for example, all AFM members that offer income protection products agreed voluntarily in 2021 to be signatories to an agreement on clarity of underwriting decisions: we see this as working in the same space.

We agree that the Consumer Duty should not be applied retrospectively. Whilst it is developed in a similar light to the 'Treating Customers Fairly' principle, the extra interpretation of fairness and the implications for the way firms behave (as per paragraph 2.36) set new expectations, and previous activity should be reviewed in the context of the prevailing standards at the time.

It is unclear at present how FCA will seek to avoid retrospectivity in the way that firms are judged in the future- by supervisors, the media, or the Financial Ombudsman Service. We would wish to see some mechanism where previous rules are only applied to previous actions, and a way for the Financial Ombudsman in particular to be bound by that.

In addition, adoption of the Consumer Duty will also have consequences for other rules; for example, for life insurers, many of their obligations are set out in COBS20, and we consider that this will have to be extensively revised if the Principle is adopted.

To illustrate, the concept of fairness as a regulatory principle can bring about very different results: for a mutual insurer or friendly society one can make good arguments for dividing a sum of money 'fairly' between a group of policyholders by dividing it equally, dividing it according to need, dividing it according to contributions paid into the fund, dividing it into length of membership, and dividing it according to policy value- all with different results.

Nevertheless, in a mutual context, 'fairness' does have some value, which might be lost under a less specific consumer duty. Fairness is not the same as generosity: giving a class of policyholders a windfall payment, violates the TCF principle by giving them an unfair advantage, which becomes more unfair, the bigger the windfall. This is particularly so in a mutual, where any unfair advantage

given to one group of members must necessarily create an unfair disadvantage to all the other members.

We think the Consumer Duty may undermine the FCA's own rationale upon which COBS 20 was founded, the whole basis of which is to translate TCF into a with-profits context. We do not think this is the intention, but it needs careful consideration.

Q2: What are your views on the proposed structure of the Consumer Duty, with its high-level Principle, Cross-cutting Rules and the Four Outcomes?

In hierarchical terms we would normally see outcomes sit above rules, as the rules help define the behaviours by which the outcomes are achieved.

Q3: Do you agree or have any comments about our intention to apply the Consumer Duty to firms' dealings with retail clients as defined in the FCA Handbook? In the context of regulated activities, are there any other consumers to whom the Duty should relate?

Q4: Do you agree or have any comments about our intention to apply the Consumer Duty to all firms engaging in regulated activities across the retail distribution chain, including where they do not have a direct customer relationship with the 'end-user' of their product or service?

We agree with the approach. We would like to understand more about the circumstances where a product provider, such as an insurance company, takes any responsibilities for the actions of an intermediary.

We consider there is a risk that if one part of the distribution chain takes on a risk that emanates from another part of the chain, they may mitigate those risks by changing their approach to distribution.

We would therefore view it as a bad outcome if a result of the Consumer Duty was a reduction in choice for consumers. We suggest FCA devises a limit to how much oversight is expected of one firm on the activities of other firms in the value chain, and of the degree of intrusion a firm can expect to be on the receiving end of from a business partner.

Q5: What are your views on the options proposed for the drafting of the Consumer Principle? Do you consider there are alternative formulations that would better

reflect the strong proactive focus on consumer interests and consumer outcomes we want to achieve?

We consider that the first option, based on the delivery of good outcomes, is more appropriate. We consider firms can reasonably take responsibility for all their actions, and as a result, good outcomes should follow- and that achieving the right outcomes is the core measure.

A firm can work in the interests of its customer, but still achieve a poor outcome- and even if that is because of circumstances outside their control, they should still consider how best to mitigate the impact of a sub-optimal outcome. With regard to option 2 therefore this might not be picked up.

We are also concerned that 'best' interests is an unrealistic measure: it implies 'better than any alternative', which may set an impossibly high bar. It is also a subjective term, and implies a degree of precision to which few consumers aspire: indeed, whether it is wearing masks in crowded indoor places, or selecting investment products, people do not always choose to do what is in their 'best interests'.

Good, rather than best, is a more appropriate measure- and certainly one for which firms can more readily identify appropriate metrics. Also, with regard to the wording, we would prefer to see the use of 'retail consumer' rather than 'retail client', since firms owe a duty of care to prospective customers as well as people who are a customer/ client.

'Best interests' is a complex issue to assess for intermediated insurance sales: for an insurance company, best interests would only be achieved where the organisation had full information about the customer, and pushes them closer to the need to provide advice themselves, which will not be possible in an intermediated relationship.

For a broker or IFA, best interests would reintroduce the need to provide the best product on the market, and to adopt a broad range of criteria about the provider, including price, features, service, and outcomes. Whilst they are ideals, the extent to which these are achievable, and whether the extra work required will price out anyone but the very wealthy from advice, is not sufficiently proven in the paper.

In a mutual organisation, what may be in the best interests of one group of policyholders can easily not be in the best interests of another group. For example, SUP18.4.6 anticipates that a transfer between friendly societies is in the interests of members of each society: inevitably, the interests of members of a transferee society and a transferor may be very different, so the notion of 'best interest' is unlikely to be met.

Q6: Do you agree that these are the right areas of focus for Cross-cutting Rules which develop and amplify the Consumer Principle's high-level expectations?

Q7: Do you agree with these early-stage indications of what the Cross-cutting Rules should require?

Q8: To what extent would these proposals, in conjunction with our Vulnerability Guidance, enhance firms' focus on appropriate levels of care for vulnerable consumers?

We agree that the rules, properly crafted, add amplification helpfully to the high-level principle.

Organisations have generally already reviewed practices in light of the FCA guidance on vulnerable customers, and subject to a reasonable implementation period, would expect to view the extra granularity provided by the rules as helpful additions to their current approach.

Looking at the detailed wording of the cross-cutting rules, we consider:

- The need to act in good faith is appropriate.
- The need to take reasonable steps to avoid foreseeable harm to customers would be appropriate, though the addition of “all” is of questionable value and is inconsistent with “reasonable”: if the duty is only to take such steps as are reasonable, which it must be, then the word “all” only serves to create confusion or to raise people’s expectations.
- The duty to “take all reasonable steps to enable customers to pursue their financial objectives” is not appropriately worded. If my financial objective is to own a super-yacht and sail it to my mansion in Bermuda, I should have no expectation that my insurer should have a duty to take any steps, reasonable or not, to help me fulfil it. It may be that what is meant is “take reasonable steps to enable customers to pursue their reasonable financial objectives”, but even that goes too far: my insurer doesn’t necessarily know (or need to know) my financial objectives, especially if they involve yachts and mansions; it only needs to know those that are relevant to my policy – and there is an obvious danger in imposing a duty on my insurer to make a judgement as to whether my objectives are reasonable, which would take “know your customer” much further than it has been taken in the past.
- The commentary on this in the consultation (paragraph 3.25) stresses consumers’ own responsibility for their choices, and suggests that firms should be responsible only for creating “an environment in which consumers can act in their own interests”. However, additional commentary goes on to explore how firms counter consumers’ behavioural biases, which seems inconsistent with the earlier quote, to be too intrusive. There is a risk that if this expectation is entrenched in the FCA’s rules, regulatory “creep” will develop, and the commentary will be forgotten, leaving us with this very

- widely drafted rule to be interpreted at its face value. This danger is all the greater if the Private Right of Action is implemented.
- Another area of focus for considering reasonableness would be to look at what other options there might or might not be for the target customers in the market. This is particularly important where products or services are aimed at groups of customers who would otherwise be underserved.

Q9: What are your views on whether Principles 6 or 7, and/ or the TCF Outcomes should be disapplied where the Consumer Duty applies? Do you foresee any practical difficulties with either retaining these, or with disapplying them?

We can see the sense in disapplying standards that overlap and create possible confusion. After all, Principle 6 itself was preceded by customer care concepts and polarisation of advice, and before that by policyholders' reasonable expectations.

However, where FCA believes the Consumer Duty will not be applied retrospectively, it will also need to ensure supervisors can refer back to principles 6 and 7 to review past activities in their light. FCA will also need to ensure that it is not re-inventing the wheel- adding extra compliance costs to firms that add no noticeably benefit to customers. This should be incorporated into cost-benefit analysis, and we would also wish to see post-implementation review by FCA, to consider whether the perceived benefits of the change have been realised.

Q10: Do you have views on how we should treat existing Handbook material that relates to Principles 6 or 7, in the event that we introduce a Consumer Duty?

Q11: What are your views on the extent to which these proposals, as a whole, would advance the FCA's consumer protection and competition objectives?

We are content that the way FCA has sought to explore the Duty, via a combination of principle/ outcome/ rule, adds more weight to its consumer protection approach, and that with effective supervisory effort, a measurably better net benefit to consumers.

We considered the initial iteration of the Consumer Duty would have a marginal effect, compared to the current TCF approach. In other words, the Duty would add further amplification and clarity on certain issues, but as stated in our response to DP18/5, the question in our view was not whether FCA had the right tools to act on failures of fairness and good outcomes, but whether it was using those tools to

the best effect⁴. We see examples such as the escalating cost of the Financial Services Compensation Scheme as evidence that the way FCA supervises firms needed to be addressed. We are pleased to see that the FCA has recently recognised the need to act on this via its new supervisory strategy.

Q12: Do you agree that what we have proposed amounts to a duty of care? If not, what further measures would be needed? Do you think it should be labelled as a duty of care, and might there be upsides or downsides in doing so?

It is not clear that the proposals do- or should- amount to a duty of care. A firm can act to deliver good outcomes, but ultimately customers must be allowed to make their own choices, and they may, for example, chose to stick with product terms that are 'good enough' in their view. We do not therefore suggest the proposals should be labelled as a duty of care, as this is not an accurate interpretation of the Duty, as stated elsewhere.

Q13: What are your views on our proposals for the Communications outcome?

Q14: What impact do you think the proposals would have on consumer outcomes in this area?

We agree with the approach, and the document provides some useful illustrations about what firms should take into account. Where FCA has provided some useful examples of good and bad practice, we would encourage it to explore this further, and in particular to set out a less narrow range of examples. For example, as the Consumer Duty extends to intermediaries, it might be useful to illustrate expectations there, rather than opting for the tried and tested- and simpler- examples offered by bank statements and similar.

We consider that our members actively adopt good practice on consumer communications. However, it is also difficult sometimes to get the balance between meeting all regulatory expectations, and presenting information in a useable and brief format. We imagine firms will respond by seeking to simplify high-level documents, but where necessary signpost customers to more detailed information, or 'layered' as described in paragraph 4.16.

⁴ <https://www.financialmutuals.org/wp-content/uploads/files/AFM%20response%20to%20FCA%20paper%20on%20duty%20of%20care.pdf>

Q15: What are your views on our proposals for the Products and Services outcome?

Q16: What impact do you think the proposals would have on consumer outcomes in this area?

We recognise some of the examples of harm expressed by FCA. The examples provided illustrate the nature of harm that might occur, though assuming problems are seen in a minority of cases, the examples do not give a balanced view. It would also be useful to understand what action FCA has taken in relation to the concerns it puts forward; for example, the recently produced CMA review of leasehold arrangements on property identified the individual firms implicated, as well as the rectification action taken.

We note that of the fines levied in 2020 by FCA, three related in whole or in part to a breach of the TCF principle. This surprisingly low number is consistent with previous years too. Such a limited example set, as well as an absence of naming and shaming, means it is difficult to quantify the degree of harm that FCA seeks to address, and how the proposed Product and Service outcome sets expectations that go beyond the existing PROD sourcebook. There is a range of potential results:

- at a future point it may be that a significant increase in fines result from the Consumer Duty, and that this might demonstrate where the TCF principle and its application has been deficient;
- Equally, if there is no greater enforcement in future, this may indicate that the Consumer Duty merely dresses up the TCF principle;
- Alternatively, a further reduction in action following implementation of the Consumer Duty may indicate firms are changing behaviours and avoiding the kind of harm that, until then, 20 years of regulatory intervention had not effectively addressed.

It would be helpful if FCA could outline to what extent a firm which already fully meets the expectations of the PROD rules and principle 6 would be expected to do anything further to meet the Products and Services outcome.

Q17: What are your views on our proposals for the Customer Service outcome?

Q18: What impact do you think the proposals would have on consumer outcomes in this area?

We agree that the Customer Service outcome is an important aspect of the overall customer duty. For insurance products by way of example, a product is bought in the reasonable expectation that if and when the customer needs to claim, or when

the policy matures or is due for renewal, the firm acts in the customer's interests, in order to deal with that request fairly and efficiently.

One of the examples given cites an insurance company that requires hard copies of evidence to support a claim. We can envisage circumstances where this might cause inconvenience, but for the cash health plan market, obtaining the original receipt for low-value routine dental care (for example) is an important part of preventing fraud, by avoiding multiple claims. In this example, there is a careful balance to be made between expediting the claim, avoiding fraud, and maintaining the viability of the product.

With regards to claims, the data exercise the FCA is undertaking on value measures on GI products, will provide more helpful data on the proportion of claims a firm pays out. Similar value measures in other product areas may be informative.

Q19: What are your views on our proposals for the Price and Value outcome?

Q20: What impact do you think the proposals would have on consumer outcomes in this area?

We agree that 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: to illustrate, most mutual insurers prefer not to use price comparison sites, on the basis that ranking a product by price rarely means that the product offers good value—particularly where it only becomes apparent at a later point that the customer cannot make a claim, because their low-cost product excluded valued features. Equally, a product provider that deals with customers with empathy, or makes itself accessible to an otherwise underserved market, is delivering an element of value which will be highly prized by affected customers, but which is difficult to quantify objectively.

We consider that this outcome is rather less well-explored in the current rulebook than others, and notwithstanding recent work on GI product value and funeral plans, it is likely that firms may need greater articulation of the standards expected.

Q21: Do you have any views on the PROA that are specific to the proposals for a consumer duty?

We are unconvinced by the arguments put forward for a private right of action. We see the PROA opening the door to a US-style litigious culture.

In addition to the unintended consequences set out in paragraphs 5.11 to 5.16 of the consultation, we would urge the FCA to consider the disproportionate effect that increased litigation will have on smaller firms. Larger insurers will be able to engage expensive lawyers to defend actions brought against them. Smaller firms, with no in-house legal team, will find the costs of instructing sufficiently skilled legal expertise excessive.

As a result, this proposal would conflict with the FCA's duty to promote competition in the interests of customers, and would lead to customer detriment. Furthermore, firms will ultimately pass the costs on to customers, leading to more expensive products and further customer detriment.

The FCA point to their own authorisation of, and enforcement action against, claims management companies that pursue baseless or vexatious claims. However, enforcement action is unlikely to be taken on 'one-off' or occasional cases against a single CMC and even if it were, the defendant would have run up considerable, possibly irrecoverable, costs before regulatory action was taken. Regardless of the actions of claims management companies, 'ambulance chasing' legal firms may take advantage of the PROA and are not subject to FCA authorisation.

The PROA will allow for claims of a breach of the Consumer Duty to be tagged onto substantial heads of claim in litigation, with little consequence or cost to the Plaintiff. Those additions may lack credibility in many cases, but regardless of their merits, will still need to be argued in a defence, creating additional legal costs for defendant firms.

We equally do not believe the courts would appreciate being filled with vexatious cases, that can and should be resolved elsewhere. In our view, the imposition of a PROA would sidestep the important role of the Financial Ombudsman Service. Where there is a perceived failing in the effectiveness of FOS, the FCA should act to resolve that, rather than to construct a competing solution. We appreciate the FCA are not making specific proposals regarding the PROA at this stage, but when appropriate we would suggest these factors and the impacts on smaller firms should be carefully considered in the cost benefit analysis.

Q22: To what extent would a future decision to provide, or not provide, a PROA for breaches of the Consumer Duty have an influence on your answers to the other questions in this consultation?

We think this is a relevant question. Were a PROA presented as an integral part of the Consumer Duty, we think it would alter dramatically the enthusiasm and capacity of the industry to embrace the Consumer Duty.

It would be a poor outcome therefore to pursue the PROA if that resulted in the undermining of the wider case.

Q23: To what extent would your firm's existing culture, policies and processes enable it to meet the proposed requirements? What changes do you envisage needing to make, and do you have an early indication of the scale of costs involved?

Q24: [If you have indicated a likely need to make changes] Which elements of the Consumer Duty are most likely to necessitate changes in culture, policies or processes?

Q25: To what extent would the Consumer Duty bring benefits for consumers, individual firms, markets, or for the retail financial services industry as a whole?

Q26: What unintended consequences might arise from the introduction of a Consumer Duty?

Q27: What are your views on the amount of time that would be needed to implement a Consumer Duty following finalisation of the rules? Are there any aspects that would require a longer lead-time?

We have not undertaken detailed analysis of the costs and benefits of FCA's proposals. Members of AFM are owned by their customers, and in recent consumer research, customers acknowledged that the single greatest value of mutual ownership was that the organisation worked in the best interests of its customers.

That said, we anticipate that the detailed rules in any subsequent consultation will pose significant new requirements on most firms. As we highlight elsewhere in our response, this is particularly true in respect of the fourth outcome. FCA's subsequent consultations must articulate more clearly how those extra costs will be imposed on firms, and in proportion to the benefits accrued by consumers.

In assessing this, FCA should also explore the degree to which its existing powers are fully utilised, and whether more effective intervention, and implementation of those powers could achieve the expected outcomes. Equally, FCA needs to measure what gaps the proposals close, to be satisfied that the cost-benefit case is appropriate: to illustrate, scandals such as London & Capital Finance would not have been prevented by the new rules proposed.