A new consumer duty (CP21/13)

Response by the Intermediary Mortgage Lenders Association

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IMLA

IMLA is the representative trade body for mortgage lenders who lend wholly or predominantly through intermediaries. Our 44 members (16 banks, 15 building societies and 13 specialist lenders), include 18 of the top 20 UK mortgage lenders responsible for approximately 93% of gross mortgage lending.

IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market. We welcome this opportunity to comment on the FCA's consultation on whether to introduce a new Consumer Duty.

Summary

- It is not at all clear to us what benefits a new Consumer Duty would bring. The regulator has long had the necessary powers to require firms to behave in a responsible and fair way towards their customers – just as it has long emphasised the need to focus on the outcomes experienced by those customers. The fact that the FCA is now considering imposing a new Duty, and new obligations on lenders, rather indicates that it has failed to enforce existing requirements.
- Since its creation in 2000 the FCA's predecessor, the Financial Services Authority, published numerous documents emphasising its expectations of firms and of the leadership provided by Boards and senior management. A paper on TCF Culture (July 2007) stated: *"Leadership at all levels sets the tone of an organisation, driving the behaviour of staff and the quality of*

decisions. Strategy sets the direction and priorities of the business and the focus for management. Controls, including management information are essential to satisfy managers … that the firm is delivering fair outcomes for consumers."

- There are numerous other examples of statements made by the former FSA, and the FCA, setting out the regulator's expectations of firms' behaviour towards their customers. There can be no excuse for any firm not knowing what it should be doing: the question is surely therefore – how the regulator deals with firms that do not meet expectations and do not comply with specific requirements. If, in the 21 years since the Financial Services and Market Act came into force, the regulator has been unable to enforce its own rules – why does it believe that the creation of a new package of measures will succeed where the existing framework, including the wide-ranging and comprehensive "TCF" principle, has in some, but not all, cases failed?

Responses to consultation questions

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

Paragraph 1.8 of the CP gives a number of examples of firms' behaviour which does not lead to good outcomes for their consumers. Surely the fundamental question is: if firms are guilty of this sort of behaviour, given the existing rules, principles and codes to which they are already currently subject – why are they not being called to account now? Why does the FCA think that introducing another rule will make recalcitrant firms any more likely to comply? Paragraph 2.5 of the CP notes that, in response to the earlier DP18/5: *"Some stakeholders believe that our current approach has been too rules-based and not sufficiently outcomes-focused."* Does this not prove the point? Adopting an approach which is more "outcomes focused" will require more scrutiny of those outcomes to see if the regulatory framework is being complied with, rather than layering yet further requirements on firms.

If, for example, firms are *"not being fully transparent in the information they provide"*, as stated in paragraph 2.9 – then why are they not being fully transparent and what action has the FCA taken to remedy this? Surely any firm which is complying with Principles 1, 6, 7 and 8 will not be at risk of being judged not guilty of "not being fully transparent" to the extent that this causes consumer detriment?

If, for example firms *"have not consistently focused on the needs and objective of the end consumer"* (paragraph 2.17) then how will they be able to demonstrate that they have complied with Principles 6 and 9?

Paragraph 2.21 states that the FCA is: *"increasingly looking for senior management to look pro-actively about the intent behind our rules, and impact of their actions on their customers."* This has long been within the spirit of the numerous publications issued in connection with the interpretation and embedding of Principle 6 – "TCF". If this has not been happening "consistently" then we would suggest this is more due

to a failure of rigorous supervision and enforcement, rather than to any specific deficiency in the existing regulatory framework.

In short, if firms are currently not acting in good faith and are causing consumer harm (paragraph 2.25) then we would fully expect there to be strong regulatory intervention.

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?

We believe that the new additional structure is unnecessary. Paragraph 2.30 states the FCA's belief that the existing Principles remain fit for purpose, but that *"there is a need for something more – a clear statement of expectations that goes beyond our existing Principles and Rules …".* The former FSA and the current FCA have published numerous documents setting out their expectations of firms over the years: it is hard to see how a new statement would make these any clearer. We suggest there is a strong case for the FCA to re-visit those earlier publications with a view to reminding firms that they remain valid, relevant - and enforceable.

Firms already owe consumers a duty of care under contract law – and the existing rules, Principles and guidance already referred to have on numerous occasions set out the regulator's expectations as to how much further firms should go in order to meet the required standards. It might be helpful to work up the intention behind the proposed cross-cutting rules and outcomes into a further guidance note to firms – but creating a new structure enshrined in a new Consumer Duty will only replicate much of what has already been written – and without robust supervision and enforcement, is unlikely to bring about the desired changes.

For example: paragraph 2.36 (c) suggests that the New Duty would provide "clarity on where responsibilities lie". This is already a requirement under the Senior Managers and Certification Regime. If a firm has failed to identify its "responsibilities map" under the regime – why not, and what has been done to rectify this?

Paragraph 2.36(m) states that the FCA's supervisors: *"would increasingly focus on the outcomes being experienced by consumers."* The FSA came into being in 2000. The Principles for Businesses have been in force since 2001. Discussion Paper DP7, on *Treating Customers fairly after the point of sale"* was published in June 2001. It was followed by many other papers which set out the regulator's requirements and expectations. If, twenty years on those requirements and expectations are still not being met by a minority of firms, what difference will be achieved by adding further rules and principles to the list?

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?

Agreed.

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?

In the context of mortgages, the chain of operations and inter-dependencies is such that a number of agencies and firms may be involved in designing, distributing, selling, underwriting and ultimately administering the mortgage product eventually bought by a borrower – whose direct contact with the ultimate lender may be fairly remote. It is therefore important that all aspects of the process are subject to the same high standards and levels of consumer care expected by the regulator.

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?

It strikes us that the FCA is creating an unnecessary problem for itself in trying to decide which of the two proposed sets of wording would be more appropriate. The wording of Option 1 is very general – and as paragraph 3.18 acknowledges, should already be being delivered by firms which take compliance with Principle 6 seriously. Going "a step further" and requiring firms to focus on the impact of their actions on consumers surely simply replicates the spirit of the Principles and the 6 TCF Outcomes.

The consultation paper then discusses the issues surrounding the interpretation of the expression "best interests". As paragraph 3.21 points out, a firm which is already required to comply with COBS 2.1.1R must "act honestly, fairly and professionally in accordance with the best interests of its *client* (the *client's best interests rule*). If the FCA considers that more firms should come within scope of the COBS requirements, that could presumably be achieved without having to impose a new Duty of Care across the board.

Within a mortgage context, a customer's "best interests" may be difficult to determine in an objective manner. There may be some clear-cut cases where it is evident that a product is unsuitable and has been mis-sold – but there may be large areas of ambiguity where a customer's circumstances may or may not change – as expected or unexpected – over a short period, and a mortgage adviser and lender can only advise/underwrite/decide to lend on the basis of facts put before them. Lenders are not lifestyle planners and cannot predict how an individual borrower's personal or professional life will develop. Any interpretation of "best interest" must therefore be seen (and judged) within the context of what it is reasonable for a lender to know at the time.

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?

The areas of focus are entirely reasonable – but they articulate what firms which seek to comply with the spirit of the Principles should **already** be doing – all firms should be acting "in good faith". They are also very broad – and their interpretation may differ from one sector to another. For example, taking "all reasonable steps to enable customers to pursue their financial objectives" may mean quite different levels and degrees of engagement when applied to the mortgage and investment sectors. Some borrowers may wish to move frequently, trading up as often as possible in order to maximise their equity in property. Others will be looking for their "forever home in which to establish a long-term family base. Some buy-to-let investors will want to finance a small number of properties – others will be more adventurous, looking to build larger portfolios. There are many more types of borrower, each with specific personal circumstances and ambitions, than there are types of mortgage product. The regulator needs to ensure appropriate levels of transparency, suitability and fairness – but cannot require completely bespoke products for all customers.

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

As paragraph 3.30 acknowledges, the FCA has recently published guidance providing more detail on its expectations of the level of care needed to help vulnerable customers. In the absence of specific evidence that this guidance is not being followed or is insufficient, further intervention at this stage would seem to be premature.

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?

Q10: Do you have views on how we should treat existing Handbook material that related 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?

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 would seem bizarre to disapply Principles which have been in place for 20 years and which are clear in their intent. We continue to hold that view that effective supervision of compliance with existing rules and principles is preferable to the creation of new rules and requirements.

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?

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?

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?

The FCA is right to identify communications, products and services and customer service as important consumer outcomes: but it should not require the imposition of a new "Consumer Duty" to ensure that these are delivered as the regulator requires. Paragraph 4.6 describes a number of behaviours by firms which it wishes to address. Language such as *"whether deliberately or inadvertently"*, *"key information being hidden"*, *"Failing to draw customers' attention …"* etc implies a considerable degree of carelessness or potential sharp practice which clearly needs to be called our and rectified – but the FCA already has powers to do this. If it considers that a firm's practices are causing consumer detriment it can already challenge this – and tell the firm what it expects it to do, and within a specified timescale. Where it considers that malpractice is industry-wide, it can publish guidance with which it then expects all firms to comply – and against which supervisors can assess individual firms' performance. There are probably several precedents for this: the first is the extensive work carried out by the former FSA's Unfair Contracts Team, which issued numerous publications, including –

- *Fairness of terms in consumer contracts: a visible factor in firms treating their customers fairly* (June 2008)
- *A Statement regarding "have read and understood|" declarations"* (June 2010)
- *Finalised Guidance: Unfair Contract terms – improving standard in consumer contracts* (January 2012)

- *Finalised Guidance: Statement on using switching terms in mortgage contracts under the Unfair terms on Consumer Contracts Regulations 1999* (January 2012)

The Competition & Markets Authority similarly published a number of guidance documents on unfair contract terms in 2015.

Another, older example, relates to mortgage exit administration fees. Having received complaints about industry practice the FSA conducted an investigation and acted swiftly to issue a statement in August 2007. It did not need to create new rules, principles and structures to ensure that firms amended their practice to ensure that consumers were treated fairly.

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?

These proposals are more problematic: the former FSA and now the FCA has stated in the past that it does not wish to become a price regulator – but by creating more rules it risks straying into precisely that territory. Paragraph 4.78 acknowledges that the FCA has already introduced market interventions such as price-caps or other price interventions in the rent-to-own and overdrafts markets – thereby evidencing that it already has sufficient **existing** powers to act where it sees a firm's or sector's pricing practices causing consumer detriment. Why, then, does it need to introduce a further set of rules in relation to "price and value" – which may be very subjective in terms of judgment.?

Paragraph 4.82 notes that: *"There are different reasons why consumers might end up buying poor value products."* Surely the emphasis should be on consumers being given sufficiently transparent and comprehensive information in order to be able to make an informed decision about their purchase, advised as necessary by an appropriately qualified and competent professional. Within the mortgage context it is particularly important that consumers seek advice to help them understand the financial implications of the various products on offer. An obvious example would be how to choose between a low monthly repayment rate over a long period compared with a higher monthly repayment rate paid over a shorter period. For some customers on tight budgets the former may be entirely suitable – for others, paying a loan off faster will mean that it costs less in absolute terms in the long run. But such decisions also have to be made in the context of what other financial commitments and plans the borrower may have – so explanations and illustrations will be vital to help understand what may be best in the individual's circumstances. Within that context it may be very difficult to judge that one particular mortgage product is of "poor value" when it may in fact be very suitable for a particular borrower. Similarly, some short-term loans may appear to be expensive and – when compared with longer-term alternatives – "poor value": but if a (relatively expensive) short-term loan enables a borrower to secure a target property – then who is to judge that short-term

loan as having been “poor value” if it delivered the desired result and the borrower was fully aware of what they were doing?

Q21: Do you have views on the PROA that are specific to the proposals for a Consumer Duty?

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?

The most obvious adverse consequence of a consumer of bringing a private action against a firm under a PROA would be if they lost the case and found themselves liable to pay the firm’s costs. This runs completely counter to the principle of having a free-to-consumer independent dispute resolution scheme – as provided by the Financial Ombudsman Service. Further, a decision of a court would by definition look closely at the legal arguments as to whether or not a firm was in breach of an FCA Principle. The respondent firm could be expected to defend itself robustly – and many firms, especially larger financial institutions, would have access to expert legal firepower, which would be costly for individual consumers to counter. There is a risk that the whole process would become much more aggressive and adversarial - whereas the FOS can take a more measured approach to investigating what has happened and trying to put things back to the position they were in before a particular transaction was entered into.

The FOS is also able to take a broader view – concluding that while a firm may have acted lawfully and within accepted codes/guidance etc – its actions may have had the effect of being unfair to the individual complainant. In such cases, additional compensation may be awarded but this is not generally punitive.

It is by no means clear to us that individual consumers would welcome or make use of a PROA. It will always be open to consumers to seek legal redress on the grounds of breach of contract – and there are existing provisions within the Consumer Rights Act on which a consumer could seek to sue.

It seems very odd that a PROA might be introduced with respect to a firm’s failure to comply with requirements under a Duty of Care – while no similar right applies to other aspects of the Handbook (such as the Principles). Such a piecemeal approach would likely cause confusion and argument over interpretation and definition – none of which would benefit the consumer, who simply wants a complaint or grievance to be investigated and put right.

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?

These are matters for individual firms.

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?

As argued throughout this response – it is not at all clear to us what benefits a new Consumer Duty would bring. The regulator has long had the necessary powers to require firms to behave in a responsible and fair way towards their customers – just as it has long emphasised the need to focus on outcomes. The fact that it is now seeking to impose a new Duty, and new obligations on lenders, rather indicates that it has failed to enforce existing requirements.

The imposition of new rules and requirements on firms will have inevitable cost implications, in terms of training, preparation and systems changes. If, as has been suggested (in Q), some existing Principles might be disapplied where a new Consumer Duty applies, this is likely to cause confusion – and waste time and resources while firms struggle to work out what they are being asked to do.