The Money Charity response to the FCA 'Duty of Care' consultation (Nov 2018)

The Money Charity is the UK's leading financial capability charity.

We believe that being on top of your money means you are more in control of your life, your finances and your debts, reducing stress and hardship. And that being on top of your money increases your wellbeing, helps you achieve your goals and live a happier more positive life as a result.

Our vision is for everyone to be on top of their money as a part of everyday life. So, we empower people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives.

We believe financially capable people are on top of and make the most of their money in five key areas:

- Planning (including budgeting)
- Saving
- Debt
- Financial services products
- Everyday money (including wages, cash, bank accounts)

The MONEY Charity

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Introduction

The Money Charity is pleased to have the opportunity to respond to the FCA discussion paper on a duty of care and potential alternative approaches (DP18/5, July 2018). We believe this discussion provides an opportunity to improve the FCA's regulatory framework by introducing a duty of care in an appropriate form into the FCA Principles for Businesses, where it will ground Rules and Guidance to improve consumer protection. Along with more active and transparent enforcement, we believe this could significantly improve consumer outcomes.

What this response does

First, we set out our overall view of the idea of a duty of care. Second, in the light of our overall view, we answer the specific questions asked in the FCA's discussion paper.

1. Our overall view

There are four points that shape our overall view:

1.1 The continuance of consumer harm and the need for a duty of care

Past and present behaviour of the financial services sector has given rise to many situations in which harm has been caused to consumers, for example through mis-selling, excessive interest rates on loans, near-zero interest rates on cash savings, concealed product terms, unfair fees, demand-based price discrimination in insurance etc. Despite the existence of the FCA, its Principles, Rules and Guidance and various enforcement actions, such behaviours continue to occur. These are not only perpetrated by 'fringe' or 'rogue' players, but in many cases by large 'household name' companies who make use of market power, asymmetric information or consumer inertia to enhance revenue in ways that are harmful to their customers. This suggests there is still room for improvement in the regulatory framework. From a financial capability point of view, effective regulation of financial firms' behaviour complements The Money Charity's efforts to educate young people and adults about ways they can better manage their money and avoid financial distress.

We note that the House of Lords Select Committee on Financial Exclusion (2017) called for 'a duty of care for financial services providers to exercise towards their customers' in order 'to promote responsible behaviour on the part of businesses and support sound financial decision-making by customers.' (Paragraphs 5 and 89)

Similarly, the Financial Services Consumer Panel (FSCP) has called for 'a duty of care that would oblige providers of financial services to avoid conflicts of interest and act in the best interests of their customers.'[1]

The Select Committee and the FSCP are responding to the continuing volume of public complaints about financial service providers across a wide range of product types and associated services.

1.2 The common law duty of care

Since the celebrated case of Donoghue v Stevenson (1932), the 'snail in the bottle' case, a duty of care has existed in common law. Firms have been under a legal obligation to take care to 'avoid reasonably foreseeable harm' to their consumers. This is a foundational legal principle within the law of torts. From this perspective, introducing a duty of care into the FCA framework would be an expression of an existing legal right. The difference is that, for ordinary consumers, taking action under common law is expensive and usually impractical. Placing a duty of care into the FCA framework would make it part of the day-to-day system of financial regulation, with enforcement taking place through the FCA.

Historically, the issue of 'transparency' played a role in establishing the duty of care. Ginger ale was sold in dark coloured bottles giving, as the House of Lords put it, 'no reasonable possibility of intermediate examination' by the consumer.[2] If the consumer could not see through the dark glass, how could she tell if there was a snail in the bottle?

This is particularly relevant to financial services, where contractual terms are often set out in long documents full of legal language, in small print, or are simply concealed from the customer. Some aspects of a financial service (eg how an insurance company deals with claims) cannot be inspected in advance and, indeed, may never be known by a particular customer. Some contractual terms may be clear but involve mathematical calculations or concepts difficult for the individual consumer. In effect, many financial services are sold in dark coloured bottles, making a providers' duty of care essential.

It may be argued that the common law duty of care is covered by FCA 'Principle for Businesses 2: A firm must conduct its business with due skill, care and diligence.' However, in its current wording, this Principle does not answer the question 'for what purpose?' The answer could be 'to maximise firm profits', 'to maximise executive bonuses' or – going to the other extreme - to 'place the interests of the customer before

[1] Financial Services Consumer Panel, *A duty of care for financial services providers*, January 2017. Available at: https://www.fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017.pdf
[2] https://en.wikipedia.org/wiki/Duty_of_care

those of the firm.' The current wording feels vague and incomplete. It would benefit from a clear statement of purpose.

The vagueness of Principle 2 is reflected in the current wording of the FCA's Customer Outcomes[3] which use words such as 'fair', 'clear', 'suitable', 'acceptable' without indicating any clear standard or purpose.

To establish a clearer standard, we believe that a duty of care 'to avoid reasonably foreseeable consumer harm' should be included in the FCA Principles for Businesses.

1.3 A fiduciary duty of care

As pointed out in the Discussion Paper, there is a distinct duty of care arising in fiduciary situations, such as when one person is acting as a trustee, attorney or investment adviser for another. We agree with the FCA that these two types of duty should be considered distinctly, as they often arise in different circumstances and express different relationships between the firm and the consumer. Fiduciary relationships entail stronger duties than those arising simply from the sale of goods and services. Fiduciaries are expected to act on behalf of and in the best interests of their clients.

We accept the point made in the Discussion Paper that a fiduciary duty is 'complex and challenging to define'[4] but we find it odd that the Paper describes it as a 'negative duty'. The responsibility of a fiduciary is to act on behalf of the client/beneficiary, promoting the latter's interest. In our view, this is not merely the avoidance of a clash of interest, but a positive pursuit of outcomes beneficial to the client/beneficiary.

1.4 Should there be a single duty of care expressed as 'a duty to act in the best interests of customers'?

The idea that there should be a single duty of care, expressed as 'a duty to act in the best interests of customers' has been suggested by some leading voices in the consumer sector, such as by the Financial Services Consumer Panel, quoted on page 2 above. We note that, under the FCA Conduct of Business Sourcebook (COBS) 2.1, firms are already required to act in their client's best interests in certain defined situations.[5]

As a member of the consumer/charity sector, and as providers of financial capability education, we are attracted to this idea. It would be an easy right to explain and a fair

[3] Annex 2 of the FCA Discussion Paper DP18/5, page 37.

[4] FCA, *Discussion Paper on a duty of care and potential alternative approaches*, DP18/5, pp 35-36.

[5] Discussion Paper, page 11 and COBS 2.1.1, available at: https://www.handbook.fca.org.uk/handbook/COBS/2/1.html

test for the financial services sector to pass. It would challenge many of the practices referred to on page 1 of this response, which have given, and continue to give rise to, consumer harm.

We note that the EU Insurance Distribution Directive (IDD) requires that insurance distributors 'must always act honestly, fairly and professionally in accordance with the best interests of their customers.'[6] This directive applies to insurers, insurance intermediaries, price comparison websites/aggregators and ancillary insurance intermediaries. The IDD has been transposed into UK law and into the FCA Handbook, effective from 1 October 2018, in the Insurance Conduct of Business Sourcebook (ICOBS) 2.5:

> **"The customer's best interests rule**
>
> A *firm* must act honestly, fairly and professionally in accordance with the best interests of its *customer*."[7]

If a 'customer's best interests' test can be applied to insurance – a market involving a wide range of customers' needs and interests – then it is hard to see why the same test could not be applied to all financial services.

It seems that the direction of financial service regulation is toward extending the 'customer's best interests' test to new areas. This being the case, it makes sense for the FCA to give serious consideration to introducing such a general test, alongside the specific tort-based and fiduciary duties of care.

With these general points in mind, we move on to answer the FCA's specific questions:

2. The Money Charity's response to the Consultation Questions

Question 1: Do you believe there is a gap in the FCA's existing regulatory framework that could be addressed by introducing a New Duty, whether through a duty of care or other changes?

Yes, we believe there is a gap in the FCA regulatory framework, in that it does not contain an explicit duty of care along the lines discussed above.

Given the FCA's multi-level approach to regulation (Principles – Rules – Guidance), we feel the right place to introduce a duty of care is within the Principles for Businesses.

[6] https://www.pwc.co.uk/financial-services/assets/pdf/insurance-distribution-directive-are-you-ready-january2018.pdf

[7] https://www.handbook.fca.org.uk/handbook/ICOBS/2/5.html

This would improve the regulatory framework in two ways:

First, by introducing a duty of care for financial services consistent with the public's existing rights under the common law, the FCA would make those rights more enforceable in practice by making them an aspect of statutory regulation and relieving harmed customers from the need to take expensive court actions.

Second, by grounding the FCA's rules and guidance in a duty of care principle, the FCA's regulatory framework would become more coherent and consistent. The idea of avoiding harm to consumers, instead of appearing in FCA documents in its current loose fashion, would be grounded from the outset in the FCA Principles for Businesses.

A duty to avoid harm would force firms to question the likely impact of their products and services, knowing that if they did something that harmed their customers they would likely face FCA enforcement action and possibly private legal action arising from their breach of FCA Principles. This would give pause for thought.

Taking into account the existing common law duties of care and the 'customer's best interests' test of the EU Insurance Distribution Directive and ICOBS 2.5, the duty of care should contain three things:

- In all situations, a duty to take care to avoid reasonably foreseeable harm to the customer.
- Where there is a relationship of trust, a duty to act in the best interests of the customer. [8]
- Extending IDD/ICOBS 2.5 to all financial services, a duty to act honestly, fairly and professionally in accordance with the best interests of the customer. [9]

Question 2: What might a New Duty for firms in financial services do to enhance positive behaviour and conduct from firms in the financial services market, and incentivise good consumer outcomes?

One of the challenges for financial regulation is that the UK's financial services sector is one of the more carnivorous parts of the economy, containing some activities that are deliberately designed to inflict harm on others. For example, when an investor shorts the stock of a particular company, the investor is trying to harm others involved with that company either as shareholders or managers, while profiting him or herself. This is seen as being an acceptable part of 'the rules of the game'. *Caveat emptor* prevails in transactions among well-resourced players in investment markets, who are seen as

[8] This develops the wording suggested on page 19 of the Discussion Paper.
[9] This develops the wording suggested on page 18 of the Discussion Paper.

being capable of looking after themselves, including taking expensive legal action against each other, should they feel the need to do so.

The danger for ordinary consumers is that these carnivorous attitudes flow over into markets for consumer financial services, where some firms or individuals may feel that if the consumer accepts a particular product on disadvantageous terms, this is their lookout, not the responsibility of the firm. From this arises the need for consumer protection, including FCA action on high-cost credit, product misinformation, unfair selling techniques, and so on. The role of the FCA in restraining some of the practices most detrimental to consumers is appreciated by the consumer and charity sectors, though generally we feel the FCA could be stricter and go further.

A duty of care would apply to suppliers of financial services the same behavioural standard placed on suppliers of goods and services in other markets, ie a duty of care 'to avoid reasonably foreseeable harm' to their consumers. This is a reasonable duty, which has existed in UK law since the celebrated case of Donoghue v Stevenson (1932).

What is surprising is not the idea of introducing a duty of care into the FCA framework, but that some people in the financial services sector should feel that they should not be bound by such a duty. The FCA discussion paper reports that:

> "Some stakeholders said that a duty of care would result in firms introducing a new set of highly complex rules for staff to understand and follow and these changes could result in additional and unnecessary layers of complexity and uncertainty. Some said this could have an effect on their product provision and approach to innovation. This would result from a real or perceived increased risk to firms of **costly and extensive legal action, with potentially large redress payments** being passed on as increased costs to consumers."[10] (Emphasis added)

This is exactly the point. Legal action leading to large redress payments (as happened for example with PPI) arises when financial services companies engage in actions that have later been found to be illegal and harmful to consumers, trading on the information asymmetry between consumers and firms and/or other forms of unfair market power. The point of introducing a duty of care is to get financial firms to think about potential harm in advance and not seek to inflict it, ie to behave in the same way that supermarkets, car manufacturers and other providers of consumer goods and services are expected to behave.

In our view, the desire of some in the financial sector to be able to inflict harm without redress is an unfortunate flow-over into the consumer sector of the carnivorous

[10] FCA, *Discussion paper on a duty of care and potential alternative approaches*, DP18/5, July 2018, p 6.

approach taken to investment markets, a behavioural pollution that the framework for financial service regulation should do its best to prevent.

Question 3: How would a New Duty increase our effectiveness in preventing and tackling harm and achieving good outcomes for consumers? Do you believe that the way we regulate results in a gap that a New Duty would address?

There is a gap in the present framework in that the idea of 'avoiding harm to consumers' is not fully and consistently grounded at all levels of the FCA framework. This leads to a sense of things not being 'fully joined up.' For example, in many places in its papers on the duty of care (July 2018) and its approach to consumers (July 2018), the FCA refers to its desire to 'avoid harm' to consumers. However, it is not clear where this wording comes from. It is not in the three operational objectives of the Financial Services and Markets Act 2000, nor is it in the FCA's eleven Principles for Businesses.[11] Some of the Principles for Businesses are worded inconclusively, for example it is not clear whether Principle 2 (skill, care and diligence) is primarily a consumer protection principle, or has prudential or shareholder interests at heart.

In our view this ambiguity can be resolved by adopting a duty of care that is clearly a consumer protection duty. As argued earlier in this response, the best place to do this would be in the FCA's Principles for Businesses. Once set out in the Principles, the duty of care can be ramified logically and consistently into Rules and Guidance, and into FCA policy statements.

It must be said, however, that no form of words can be effective if not backed up by action. As we have pointed out in previous consultation responses, episodes of consumer harm caused by the actions of regulated firms continue to develop as it were 'under the nose' of the FCA, either without regulatory intervention or with intervention occurring only after a delay and the build-up of political pressure.

The future effectiveness of the FCA in protecting consumers will be an outcome not just of certain words on paper, but of timely and adequate regulatory intervention.

Question 4: Should the FCA reconsider whether breaches of the Principles should give rise to a private right for damages in court? Or should breaching a New Duty give this right?

The advantage of including the duty of care in the FCA framework is that the FCA can then enforce this duty as part of its regular supervision, relieving customers of the need to take expensive court action. This gives more 'teeth' to the duty of care than purely relying on the common law.

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[11] https://www.fca.org.uk/about/principles-good-regulation

However, we see no reason to exclude consumers from taking action in the courts should they need to and can overcome the cost barrier. Knowing that particularly egregious harmful actions might lead to court cases would provide financial firms with an additional incentive to behave well. This is consistent with the position taken in product liability law, where statutory rights under the Consumer Protection Act do not prohibit an injured consumer from taking civil action under the common law.[12]

Allowing consumers to take court actions for breaches of FCA Principles would complete the picture of consistency between civil law and FCA regulation and improve the joined-up-ness of the whole system.

Question 5: Do you believe that a New Duty would be more effective in preventing harm and would therefore mean that redress would need to be relied on less?

It is in the nature of financial service firms to try to find ways around rules that limit their activities, but the more clear and consistent the regulatory framework becomes, the stronger the chances of achieving positive outcomes for consumers and avoiding harm occurring in the first place. If firms see that there is a clear set of rules, and that these rules are enforced diligently, there should be a reduction in attempted breaches and therefore less need for redress.

Summary and proposed duty of care

To summarise, we think the FCA has an opportunity to make its regulatory framework clearer and more consistent by introducing a duty of care at the level of the Principles for Businesses, from where it can be ramified into Rules, Guidance and the supervision and enforcement regimes.

Taking into account the existing common law duties of care and the 'customer's best interests' test of the EU Insurance Distribution Directive and ICOBS 2.5, the duty of care should contain three things:

- In all situations, a duty to take care to avoid reasonably foreseeable harm to the customer.
- Where there is a relationship of trust, a duty to act in the best interests of the customer. [13]

[12] Rod Freeman, Sarah-Jane Dobson and Carol Roberts, Cooley LLP, *Product liability and safety in the UK (England and Wales): overview*. Available at: https://uk.practicallaw.thomsonreuters.com/w-013-0564?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1

[13] This develops the wording suggested on page 19 of the Discussion Paper.

- Extending IDD/ICOBS 2.5 to all financial services, a duty to act honestly, fairly and professionally in accordance with the best interests of the customer. [14]

(end)

[14] This develops the wording suggested on page 18 of the Discussion Paper.