

## New FCA Principle 12: Consumer Duty

September 8, 2022

### Key points

- The FCA is introducing a new Principle for Businesses, namely Principle 12: “A firm must act to deliver good outcomes for retail customers.” Firms will need to assess and evidence how they are acting to deliver good outcomes for their retail customers throughout the lifecycle of the products and services they provide to them.
- The new Principle and associated rules are far-reaching and designed to lead to a “major shift in financial services”, and the time and resources required by firms to demonstrate compliance should not be underestimated.
- Firms will be required to comply with Principle 12 with respect to all new in-scope products and services from 31 July 2023, and with respect to all in-scope products and services from 31 July 2024. Notwithstanding these dates, the FCA has stated that by the end of October 2022, firm management/boards must have agreed implementation plans.
- In general, products and services will be in-scope if they relate to a firm’s “retail market business”. Whilst this will be of most significance to firms with retail clients, it may also apply to firms who do not have retail clients, but whose products or services are “in a distribution chain” with retail clients.
- With respect to in-scope products and services, Principle 12 will replace and impose a higher standard than Principle 6 (Customers’ interests) and Principle 7 (Communications with clients) currently require. Principles 6 and 7 will continue to apply for out-of-scope products and services.

### Introduction<sup>1</sup>

In July 2022, the Financial Conduct Authority (FCA) issued its final rules on a consumer duty with Policy Statement 22/9,<sup>2</sup> along with guidance in Finalised Guidance 22/5.<sup>3</sup> Under these new rules and guidance, a new Principle for Businesses—Principle 12—will come into force providing:

*“A firm must act to deliver good outcomes for retail customers”.*

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Alongside Principle 12, the FCA has published a list of three “Cross-Cutting Obligations” which “exhaust what is required under Principle 12”,<sup>4</sup> and which “define how firms should act to deliver good outcomes for retail customers”.<sup>5</sup> These Cross-Cutting Obligations—which are set out in a new section of the FCA Handbook, PRIN 2A.2—are then further explained by four overarching “Outcomes” which firms should seek to attain.

The FCA has said that Principle 12 and the associated rules are designed to lead to a “major shift in financial services”, and the new rules are also intended to allow the FCA to act more quickly and assertively if they see new problems.<sup>6</sup> This type of approach is part of the FCA’s broader shift to becoming a more “outcomes-focused” regulator. The desire to focus on outcomes is an aim for the FCA itself, requiring the regulator to demonstrate how it is measuring and delivering on its own aims and outcomes.<sup>7</sup> It is not just about the FCA’s outcomes, however: the FCA is also trying to shift firms towards focusing on their own outcomes, and one of the FCA’s stated expectations in the Final Guidance on the new rules is that firms should, “put consumers at the heart of their business and focus on delivering good outcomes for customers”.<sup>8</sup>

It should be noted that whilst Principle 12 is intended to impose higher obligations than are currently in force (to “rais[e] the bar for the firms [the FCA] regulate[s]”<sup>9</sup>), the new Principle is not intended to “change the nature of a firm’s relationship with any given retail customer”, and in particular does not create a fiduciary relationship where one would not otherwise exist.<sup>10</sup> Rather, Principle 12 and the Cross-Cutting Obligations are to be interpreted “in accordance with the standard that could reasonably be expected of a prudent firm” in relation to the same activity regarding the same product, given the needs and characteristics of retail customers in the target market.<sup>11</sup>

It should be noted that the FCA’s rules and guidance are very detailed and prescriptive in parts, and this article is only intended to summarise the key points and issues which firms need to consider and prepare for.

## **Commencement Date and Preparation Needed**

Principle 12 and the associated rules and guidance will only come into force from 31 July 2023 (for products and services provided after 31 July 2023) and 31 July 2024 (for products and services which have already been provided/entered into by 31 July 2023 and which are not marketed or distributed thereafter<sup>12</sup>).

The FCA has delayed commencement in this way, however, because it says that the new Principle 12 and rules “will require a significant shift in both culture and behaviour”,<sup>13</sup> and firms will need to use the next year to prepare for the new regime.

In particular, the FCA has specified the following milestones for firms:<sup>14</sup>

- By the end of October 2022, each firm’s board/management body must have agreed implementation plans and maintain oversight of their delivery, to ensure that the implementation work is sufficient to meet the standards in the new duty.
- Product manufacturers will need to share key information with distributors three months ahead of the implementation deadline.
- Firms must engage with the FCA if they plan to withdraw any products or services on account of the new consumer duty, so that the FCA can identify if there are any potentially significant impacts on consumers.

It is important to note that the new Principle 12 and rules will be relevant in all parts of a firm's engagement with the FCA, from authorisations, to supervision, to enforcement, though of course, it will likely take some time before we start seeing any enforcement cases.

## **In-Scope Products and Services**

Principle 12 is an attempt to provide greater protection to “retail customers”, with this protection going beyond the current Principle 6 (the duty to treat customers fairly) and Principle 7 (the duty to communicate to clients in a way which is clear, fair and not misleading). Indeed, the FCA has stated that *“Principle 12 imposes a higher and more exacting standard of conduct in relation to a firm's retail market business relative to what Principles 6 or 7 would have otherwise required.”* As a result, the FCA has decided that where Principle 12 applies, Principle 6 and Principle 7 will no longer apply; conversely, where Principle 12 does not apply, Principles 6 and 7 will continue in effect.

The definition of “retail market business” is new to the FCA Handbook, and it provides that this term covers all regulated and ancillary activities,<sup>15</sup> of a firm “in a distribution chain (including a manufacturer and a distributor) which involves a retail customer”. From this definition is then carved out certain products and activities when Principle 12 will not apply. Circumstances when Principle 12 will not apply include:

- In relation to products and services which are only marketed and approved for distribution to non-retail customers.
- When one firm provides a product or service to another firm, even if that is to enable the second firm to distribute a product to a retail customer.
- Activities relating to “non-retail financial instruments”, including those where the marketing material/prospectus makes clear that the instrument is only offered to professional clients or eligible counterparties and the issuer or distributor has taken reasonable steps to ensure that it is only directed to such counterparties, or where a minimum denomination/investment of £50,000 applies.
- In relation to the promotion or offer of certain specified types of liquid, listed financial instruments, which are not a collective investment scheme, AIF or structured financial product.

These exclusions from the scope of Principle 12 are explained in more detail in the new definition of “retail market business”.

It should be reiterated that just because a firm does not itself have retail customer clients, does not mean that it will not be found to have in-scope “retail market business”. In particular, a firm may have an in-scope “retail market business” if it is able to “determine or materially influence retail customer outcomes in connection with the product”.<sup>16</sup> Firms must therefore consider whether they have any Principle 12 obligations even if they themselves do not have retail customer clients.

## **The “Cross-Cutting Obligations”**

As noted above, there are three “Cross-Cutting Obligations” which are said to exhaust Principle 12. These rules apply “at all stages of the customer journey and during the whole lifecycle of a product”.<sup>17</sup> As a result, firms will need to “keep products under

regular review and consider the impact of any changes they make to those products”,<sup>18</sup> and to act both “proactively and reactively”.<sup>19</sup>

We set out the three Cross-Cutting Obligations as follows, along with a summary of the relevant commentary and guidance. It should be noted that the FCA’s rules and guidance on these Obligations are detailed and in some places quite prescriptive.

- Act in good faith towards retail customers.<sup>20</sup>
  - This includes acting with honesty, fairness, and open dealing, and consistently with the reasonable expectations of retail customers.<sup>21</sup>
  - A firm would not be acting in good faith if it fails to take account of retail customers’ interests, if the firm seeks inappropriately to manipulate or exploit retail customers, if the firm takes advantage of a retail customer or their circumstances (e.g. characteristics of vulnerability<sup>22</sup>), or if the firm carries out a particular activity to a higher standard or more quickly when it benefits the firm compared to when it benefits a retail customer.<sup>23</sup> This does not mean that a firm is prevented from pursuing legitimate commercial interests or seeking a profit.<sup>24</sup>
  - Where a firm identifies that customers have suffered foreseeable harm, a firm must act in good faith and take appropriate action to rectify the situation, including by providing redress where appropriate.<sup>25</sup> This would not apply where the risks were inherent in the product, and when the firm reasonably believed that the relevant retail customer understood or accepted those risks.<sup>26</sup>
- Avoid causing foreseeable harm to retail customers.<sup>27</sup>
  - The FCA is clear that foreseeable harm may be caused by act or omission, and by a firm in its direct relationship with a retail customer or its role in the retail chain.
  - Firms must ensure that all aspects of its products and services (including design, marketing and sale) avoid causing foreseeable harm, and ensure that no aspect of its business involves the unfair exploitation of behavioural biases or characteristics of vulnerability of retail customers. Firms must identify the potential for harm if it withdraws a product, the products change or its understanding about the impact of the product or service on retail customers changes. Firms must respond to emerging trends (including FCA actions/communications) which identify new sources of harm, and take appropriate action to mitigate the risk of actual or foreseeable harm.<sup>28</sup>
  - In the context of an ongoing relationship with a retail customer, firms must act to avoid causing foreseeable harm throughout the lifecycle of the product or service.<sup>29</sup>
  - This duty does not require a firm to prevent all harm, particularly when a product or service has inherent risks which retail customers accept when selecting the product, and which the firm reasonably believes that the retail customer understands.
- Enable and support retail customers.
  - Firms must enable and support retail customers to pursue their financial objectives.

- The scope of this duty will depend on the type of product or service provided—for example, in the provision of execution-only services, the firm can assume that the “financial objective” is to purchase, use and enjoy the benefits of the product or service in question.<sup>30</sup> By contrast, in the provision of discretionary or advisory services, firms may usually rely on what the customer has disclosed about their financial objectives,<sup>31</sup> as well as other information which the firm must obtain under a provision of law or the FCA’s rules.<sup>32</sup> Firms will have to have reasonable regard to the circumstances and any other facts known to them.
- Firms must enable and support customers to make good choices in their interests, including ensuring that the firm’s products and services do not frustrate the objectives and interests of retail customers. Firms must make sure that retail customers have the information and support they need, when they need it, to make and act on informed decisions, and to enable retail customers to enjoy the use of their product and to switch or exit the product when they want to without unreasonable barriers or delay. Firms must take into account retail customers’ behavioural biases and characteristics of vulnerability in all their interactions.
- Firms are not expected to go beyond what a prudent firm carrying out the same activity in relation to the same product would do, taking into account the needs and customers of retail customers.

## The “Outcomes”

The FCA has then specified four “Outcomes” to define what is required by Principle 12 and the Cross-Cutting Obligations, but which are only guidance and do not “exhaust” those rules.<sup>33</sup> As a high level summary, these are as follows:

- Products and Services Retail Customer Outcome.<sup>34</sup>
  - Particular Outcomes are specified for various different actors in the distribution chain. This includes, for example, an obligation on a manufacturer to maintain, operate and review the process for approving products and significant adaptations to products, before it is marketed or distributed to retail customers. The FCA has given detail on what these processes should constitute, including detailed provisions such as specifying the target market, characteristics, risk profile, complexity and nature of the product, the characteristics of retail customers in the target market, and then ensuring that the design and distribution strategy of the product meets those needs, characteristics and objectives. Products will need to be reviewed and tested. There is then guidance on this Outcome specified for distributors as well.
- Price and Value Retail Customer Outcome.<sup>35</sup>
  - Firms must ensure that retail customers receive a “fair value” for products, and carry out regular value assessments on those products. The FCA has specified various ways in which the assessment of “fair value” must be carried out, both for a manufacturer and a distributor of products.
- Consumer Understanding Retail Customer Outcome.<sup>36</sup>
  - Firms must support a retail customer’s understanding so that their communications meet their information needs, are likely to be understood by retail customers, and equip those customers to make decisions that are effective,

timely and properly informed. Firms must ensure that their communications are clear, fair and not misleading. Various other requirements are specified, including to test, monitor and adapt communications.

- Consumer Support Retail Customer Outcome.<sup>37</sup>
  - Firms must design and deliver support to retail customers so that they meet the customer’s needs, including for customers with characteristics of vulnerability, ensure the product can be used as reasonably anticipated, ensure that customers are given sufficient opportunity to understand and assess their options and risks, and ensure that they do not face unreasonable barriers during the lifecycle of the product (including if they want to make general enquiries about the product, transfer to a new provider, access a benefit, amend the product, submit a claim, make a complaint or cancel a contract).

## Governance and Culture

As has been a consistent theme in modifications to the FCA’s regulatory regime in recent years, the rules associated with Principle 12 place specific requirements to ensure that compliance with Principle 12 is cemented within firms’ governance and culture. Most notably:

- Firms must monitor compliance with their obligations under Principle 12 and PRIN 2A, and particularly any risks that they are not meeting the Cross-Cutting Obligations.<sup>38</sup> The nature and frequency of monitoring will depend on the nature of the firm’s business,<sup>39</sup> but this must be done “regularly”.<sup>40</sup> The monitoring must permit the firm to determine at least whether retail customers are being or have been sold products that are designed to meet their needs, characteristics and objectives, whether they are receiving fair value, whether they are equipped with the right information, and whether they receive the support they need.<sup>41</sup>
- Firms must have processes in place to identify the root causes of any failure to deliver the required outcomes for retail customers,<sup>42</sup> and take appropriate action to address any failings.<sup>43</sup> In particular, firms may be under an obligation to provide redress.<sup>44</sup>
- Each firm must prepare a report for its governing body setting out the results of its monitoring, and any actions required as a result of that monitoring.<sup>45</sup>
- At least annually, each firm’s governing body must review and approve the firm’s report on the outcomes being received by retail customers, confirm whether it is satisfied that the firm is meeting its obligations under Principle 12 and PRIN 2A, and assess whether the firm’s future business strategy is consistent with Principle 12 and PRIN 2A. The governing body must also agree any action required to address any identified risks or instances where customers may not or have not received good outcomes, and make amendments to the business strategy as required.<sup>46</sup>

Further, a new Individual Conduct Rule has been added to the Conduct Rules for Conduct Rules Staff under the Senior Managers and Certification Regime, requiring members of Conduct Rules Staff to “act to deliver good outcomes for retail customers”, where those actions are within the scope of Principle 12.<sup>47</sup> The FCA has noted that this Rule is likely to be particularly important for more senior individuals, particularly Senior Managers, as they are likely to have a greater ability to influence the outcomes experienced by retail customers.<sup>48</sup>

<sup>1</sup> Under section 29 of the UK Financial Services Act 2021, the FCA was placed under an obligation to consult on, and if appropriate make rules, specifying that FCA-authorised firms owe a duty of care to consumers. Under the Act, the FCA had to issue any such rules by August 2022.

<sup>2</sup> PS22/9, A new Consumer Duty: Feedback to CP21/36 and final rules, <https://www.fca.org.uk/publication/policy/ps22-9.pdf>.

<sup>3</sup> FG22/5, Final non-Handbook Guidance for firms on the Consumer Duty, <https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf>.

<sup>4</sup> PRIN 2A.2.26 R.

<sup>5</sup> PRIN 2A.2.27 G.

<sup>6</sup> <https://www.fca.org.uk/news/press-releases/fca-consumer-duty-major-shift-financial-services>.

<sup>7</sup> See, for example, the FCA 2022-25 Strategy Paper, <https://www.fca.org.uk/publication/corporate/our-strategy-2022-25.pdf>, as well as the FCA publication on Outcomes and Metrics, <https://www.fca.org.uk/data/fca-outcomes-metrics>.

<sup>8</sup> <https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf>, paragraph 1.9.

<sup>9</sup> <https://www.fca.org.uk/news/press-releases/fca-consumer-duty-major-shift-financial-services>.

<sup>10</sup> PRIN 2A.1.11 G.

<sup>11</sup> PRIN 2A.7.1 R.

<sup>12</sup> These are known as “closed products”, which includes products and services where there is an existing contract in place with a retail customer entered into before 31 July 2023 or where the product is not marketed or distributed to retail customers on or after 31 July 2023.

<sup>13</sup> FG22/5, paragraph 10.1.

<sup>14</sup> PS22/9, paragraph 12.9.

<sup>15</sup> As well as payment services and electronic money services.

<sup>16</sup> PRIN 2A.1.13 G.

<sup>17</sup> PRIN 2A.2.23 G.

<sup>18</sup> PRIN 2A.2.23 G.

<sup>19</sup> PRIN 2A.2.24 G.

<sup>20</sup> PRIN 2A.2.1 R.

<sup>21</sup> PRIN 2A.2.2 R.

<sup>22</sup> See PRIN 2A.7.4 G.

<sup>23</sup> PRIN 2A.2.3 G.

<sup>24</sup> PRIN 2A.2.4 G.

<sup>25</sup> PRIN 2A.2.5 R.

<sup>26</sup> PRIN 2A.2.6 R.

<sup>27</sup> PRIN 2A.2.8 R.

<sup>28</sup> PRIN 2A.2.10 G.

<sup>29</sup> PRIN 2A.2.11 G.

<sup>30</sup> PRIN 2A.2.16 G.

<sup>31</sup> PRIN 2A.2.17 G.

<sup>32</sup> PRIN 2A.2.18 G.

<sup>33</sup> PRIN 2A.2.28.

<sup>34</sup> PRIN 2A.3.

<sup>35</sup> PRIN 2A.4.

<sup>36</sup> PRIN 2A.5.

<sup>37</sup> PRIN 2A.6.

<sup>38</sup> PRIN 2A.9.1 R and PRIN 2A.9.2 G.

<sup>39</sup> PRIN 2A.9.3 G.

<sup>40</sup> PRIN 2A.9.8 R.

<sup>41</sup> PRIN 2A.9.9 R.

<sup>42</sup> PRIN 2A.9.11 R.

<sup>43</sup> PRIN 2A.9.12 R.

<sup>44</sup> PRIN 2A.10.

<sup>45</sup> PRIN 2A.8.3 R.

<sup>46</sup> PRIN 2A.8.4 R and PRIN 2A.8.5 R.

<sup>47</sup> COCON 2.1.6 R.

<sup>48</sup> COCON 4.1.30 G.

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