Responsible Finance Response: A new Consumer Duty: Feedback to CP21/13 and further consultation

About Responsible Finance

Responsible Finance is the only UK industry association for Community Development Finance Institutions (CDFIs). We believe in a fair financial system where investment flows into communities to create positive economic, social and environmental impact. To enable this we lead a strong responsible finance sector so communities have access to finance to transform lives. Our members make loans in disadvantaged communities that are not adequately served by mainstream financial service providers.

Responsible finance providers are mission driven not-for-profit or asset-locked organisations. They offer affordable credit and support to people who are under-served by mainstream finance providers who may otherwise borrow from high-cost lenders, illegal loan sharks or hard-pressed friends and family. Access to affordable credit improves the wellbeing and resilience of individuals by offering them a tool to smooth fluctuating incomes, cover unexpected calls on their finances, or pay for expected larger expenses such as a new washing machine or the school summer holidays. Alongside this responsible finance providers offer wrap around services such as helping people to claim benefits and providing budgeting advice.

There have been a number of high-profile market exits of commercial lenders who serve customers in this space in recent years but the growth in the supply of alternatives like CDFIs is not keeping pace. This means that when people – like the hundreds of thousands of people who relied on the Provident for their credit needs – face moments of vulnerability when their car breaks down or they need to replace their washing machine, it can push them into crisis or potentially the hands of illegal lenders. It's essential we work together to scale up alternatives at pace.

About Our Response

We welcome the opportunity to respond to the second consultation on the proposed new Consumer Duty. We happy to be contacted to provide further detail on any of the points made. In addition to our specific responses to the questions, we urge the FCA to:

- Conduct meaningful sector specific engagement to help firms better understand what is required of them when implementing the new Consumer Duty, particularly for the community finance sector which has less resource available to interpret and implement the Duty. More sector specific examples in the guidance and webinars would be particularly helpful.
- Consider extending the implementation period to 2-3 years to give small firms sufficient time to analyse and where necessarily adapt their processes and monitoring.
- Have regard to financial inclusion when finalising the proposals to at a minimum ensure that firms do not exclude certain groups of customers from their products as a result of the new Duty. For example, firms withdrawing products from markets and redrawing their target customer market due to the higher standards placed on firms and the costs to serving more complex markets being prohibitive. The FCA should conduct monitoring of customer groups and facilitate transparency over who is underserved, in order to increase accountability among firms.

Consultation Questions

Q1: Do you have any comments on the proposed scope of the Consumer Duty? No.

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

No – we agree with a proportionate approach to the rules through the distribution chain.

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

We recommend that the implementation period is extended to 2-3 years. This would seek to give resource-poor firms enough time to review and update products and processes where necessary and test consumer outcomes.

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

No, however as above firms will need longer to review and where necessary adjust existing products and services.

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

We are reassured that the FCA has acknowledged it is not possible for all consumers to receive (or feel they have received) a good outcome. We recommend that the FCA takes firm size and structure (eg. non-profit, where good customer outcomes are likely to be higher) into account in its view on what is a reasonable application of the Consumer Duty.

Q6: Do you agree with our proposal to disapply Principles 6 and 7 where the Consumer Duty applies? No comment.

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

We believe the FCA needs to do everything in its power to simplify its rules to allow for straightforward implementation by firms. Any ambiguity and overlap could risk causing misinterpretation or confusion.

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

We continue to support the FCA taking a proportionate approach and not imposing an open-ended Duty on firms so we appreciate the clarification on foreseeable harm and financial objectives. It would be useful to have more information on what the FCA considers as consumer harm and how firms can mitigate it to ensure that the definition is consistent across the FCA, firms and the FOS.

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

It would be helpful to include more consumer credit examples in the non-Handbook guidance for this outcome, particularly for short-term credit. With examples of good and poor practice particularly when identifying and tailoring products to target customer markets.

The guidance states that "Firms should consider the appropriate level of testing, and must test products and services in a qualitative manner. For example, they could consider likely changes to consumer needs in the future and whether the product or service would continue to meet those needs." It would be helpful to clarify if this would put an expectation on firms to consider possible changes to customer circumstances, such as an income shock or car repair bill, and incorporate this into the product design in some way or further tighten affordability criteria to account for this by ensuring customers have a larger disposable income buffer. The FCA should be aware that this could further restrict access to credit for lower-income, vulnerable customers who already face limited options.

With regards to product testing, the table which describes actions likely to be consistent with the Duty says manufacturers test products before launch to assess how it is likely to function in different conditions. We recommend expanding on how far reaching the testing needs to be before launch and what kind of testing is acceptable, eg. does the FCA recommend real world testing with customers? CDFIs do not generally have the resource to run market research testing so this requirement could stifle the development of innovate new products designed to improve consumer outcomes, eg. loans with flexible repayments. Clarification that product testing is proportionate to the firm structure and size would be helpful here.

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

We welcome the FCA recognising that the costs firms incur to design and deliver products and services, including the cost of firm funding, is allowable to be included in assessment of fair value. We also welcome enabling firms to include assumptions on the credit risk that they are exposed to.

We would welcome a more thorough understanding of how vulnerability in the target market interacts with assessment of fair price and value.

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

We are concerned about the requirement to test communications given the size and capacity of community finance providers. Large scale testing and monitoring can consume huge amounts of already stretched resource. The non-Handbook guidance suggests contracting a specialist agenda or consumer representative to complete an independent review, or conducting experiments, both of which are costly. It also suggests carrying out customer surveys to test understanding; from past experience we know it can be difficult to encourage customers to fill in surveys if there is no financial incentive. This would be even more difficult when seeking to test communications such as arrears letters, where often a customer will not want to engage with the lender. This applies to customer focus groups too. We welcome the acknowledgement that firms' approach to testing will reflect capabilities and resources, however we do not feel sufficiently reassured or confident in how small community lenders will fulfil the requirements under this outcome. Eg. if a tiny fraction of customers respond to a survey, will the onus be placed on the firm to try another, more expensive method of testing consumer understanding?

Q12: Do you have any comments on our proposed requirements under the consumer support outcome and the related draft rules and non-Handbook guidance? No.

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

As stated in our introduction, there is a concern about the financial inclusion implications of the new Duty and think it is vital that the FCA has regard to financial inclusion when finalising the Duty's design and that it conducts monitoring of customer groups and facilitate transparency over who is underserved, in order to increase accountability among firms.

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

It would be helpful if the FCA could provide further guidance on the interaction between diversity characteristics and its existing definition of vulnerability to provide greater clarity around the characteristics needing additional consideration.

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

Yes but we agree that it should be kept under regular review by the FCA. We are reassured that the FCA is working with the FOS to ensure consistent interpretation of the Consumer Duty and hope that the iterative nature of the Duty will not leave financial services providers unwittingly open to complaints. Due to the fact the FOS's free case number is proposed to be reduced to 3 cases we hope to work with the FOS and FCA in the coming months to make sure community lenders, who are vulnerable to any financial shock, are watertight against opportunistic complaints.

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

We strongly advise the FCA to consider an extended implementation period of at least 2-3 years to give community lenders with limited compliance resource time to implement it and to spread the costs of implementation (including analysing existing operations, reviewing pricing, staff training, implementing monitoring processes, adapting communications, potential IT system costs). The effects of the Covid-19 pandemic are still being felt heavily by the sector. It is unlikely this position will change significantly within a year.

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

We appreciate the FCA's acknowledgement that monitoring should be proportionate to a firms' size and are keen to underline how crucial to this.

We are concerned about the amount of senior management time the FCA's supervision takes for our members already which is a huge strain on their incredibly small teams. We have heard from some of our members that they already receive what feels like a continual stream of survey requests from the FCA. Therefore any supervisory work the FCA does in relation to the Consumer Duty should replace, rather than come in addition to, existing reporting requirements, and should seek to reduce the amount of information asked of very small firms in order to be proportionate (so that senior management time can be spent more effectively on implementing and monitoring the Consumer Duty).

We understand that some financial service providers will have large teams with whole compliance departments whose time is solely dedicated to regulation, but the FCA must continue to bear in mind that this is not the case across the board.

Q18: Do you have any comments on our proposal to amend the individual conduct rules in COCON and the related draft rules and non-Handbook guidance? No.

Q19: Do you have any comments on our cost benefit analysis? No.

Q20: Do you have any other comments on the draft non-Handbook guidance?

All comments on guidance are outlined in our responses to the above questions.

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

We recommend including more examples for consumer credit firms and community finance firms with limited capabilities and resources to give them clarity on how they can fully implement the Consumer Duty in the spirit within which it was intended.