

CP21/13: A new Consumer Duty

Financial Conduct Authority

July 2021

Response from the Emerging Payments Association

Abstract

This paper sets out the Emerging Payment Association’s response to the FCA’s Consultation Paper, “A New Consumer Duty”. We welcome the FCA’s focus on consumer protection and the broad objectives behind the CP. However, we have comments on the application of certain aspects of the proposed framework to firms that provide payment services and/or issue e-money. We fear that, despite the good intention of protecting consumers, this proposition will create extra burdens on firms, providing extra costs and another layer of administration which will inevitably exclude smaller players and will create an extra barrier to market entry, resulting in the consolidation of bigger players alone and harming broader competition. We urge the FCA to consider excluding all payment that are not retail consumer-facing.

Introduction

The Emerging Payments Association (EPA) welcomes the opportunity to contribute to the Financial Conduct Authority's consultation paper (CP), "*CP21/13: A new Consumer Duty*".

The community's response contained in this paper reflects views expressed by our members and industry experts recommended by them who have been interviewed and who are referenced below. As the EPA's membership includes a wide range of companies from across the payments value chain, and diverse viewpoints across all job roles, this response cannot and does not claim to fully represent the views of all members.

We are grateful to the contributors to this response, which has been drafted by Riccardo Tordera, the EPA's Senior Policy Manager. We would also like to express our thanks to the FCA for their continuing openness in these discussions. We hope it advances our collective efforts to ensure that the UK's payments industry continues to be progressive, world-leading and secure, and effective at serving the needs of everyone who pays and gets paid.

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The section numbering below corresponds to the numbering of the 'questions for respondents' in this paper.

1. 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 appreciate the FCA's intention to create a level playing-field across all the providers, which also aligns with the strategy of the FCA's recent business plan. However, it is not clear what specific problem the FCA wants to solve relating to the payments sector. Most payments firms, both regulated and unregulated, set out to be customer-centric and to consistently provide good value, especially for vulnerable consumers. We believe that an additional Consumer Duty would be unlikely to enhance the customer centricity of those payments firms that are not providing sufficient value, while adding compliance and benchmarking costs to those that are already doing so.

Furthermore, there is no indication of how firms would be able to provide evidence that demonstrates compliance to this extra burden of duty placed upon payments firms. Measuring culture is notoriously difficult, expensive and affected by external social and economic factors, such as a pandemic. And to this extent we foresee unintended consequences of this move, including preventing new companies from entering the market, reducing competition within the market and, as a result, reducing the options and quality of payments products provided to those consumers this Consumer Duty sets out to protect.

The EPA also questions whether Consumer Duty needs to apply to all firms in the payments industry, especially as most firms in the sector deal with other firms that also do not deal directly with retail consumers. We urge the FCA to consider excluding all payment that are not retail consumer-facing from needing to adhere to the additional obligations described in this paper.

Finally, the EPA believe that the FCA's proposals are far reaching and will need to be thoroughly embedded by firms, and that the proposed timeline does not allow enough time for implementation. Systems and controls will need wholesale change, and policies and procedures will need to be tailored to the Consumer Duty requirements. Measuring outcomes will be complicated and difficult for both the FCA and for firms. Appropriate dialogue needs to take place to ensure that outcomes are being measured in an authentic and realistic way, by the firms affected and not by those firms that are outside scope. The Financial Services Act 2021 requires that the FCA must, before 1 August 2022, make such general rules about the level of care that must be provided to consumers, but it does not require those rules to apply by that time, leaving open the possibility of a transitional regime, which the EPA would welcome.

2. 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 are broadly supportive of the proposed structure, albeit that more clarity on its technicalities would be welcome. As a general consideration, we think that – whenever possible – principle-based regulation would be better than rules-based regulation, because rules almost always end up being overtaken by technological development and are extremely difficult to apply consistently in an industry such as payments, in which there are over 80 different types of firms operating across multiple geographical markets and user sectors.

In addition, we believe that as a consequence of the need for a firm to ‘get it right first time’ (identified as a desired outcome from adopting a Consumer Principle and associated rules), firms are much more likely to avoid the risk of getting it wrong. As a result, such firms would invest in and develop fewer new products and service enhancements, and intrinsically become less innovative.

We accept that companies launching new payments products need to be able to demonstrate to the FCA that they have defined their target audience before launch. However, since it is not always possible to predict who the actual purchaser of a new product or service will be, it will not be possible to ensure a product and service fit that is exactly right for every user or user type. Few payments products are launched in their final form at first iteration; an agile product development process is by design, iterative in nature, deriving feedback from the market on what does and does not work to enhance subsequent versions and, ultimately, produce the final product.

Once again, as a result of this well-intended enhanced level of oversight over a firm’s internal systems and processes by the FCA implied by this approach, the amount of choice, quality and value to consumers could well diminish. Which we are sure is exactly the opposite of what the FCA intends.

The EPA observes that the FCA is attempting to play the role of the marketplace, which would seem to be a major broadening of its purpose. Such a shift is fraught with risk and likely to dissatisfy all stakeholders while not achieving its desired outcome.

3. 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?

While we understand the intention here, we think that this could have unintended adverse effects in the payments sector. In particular, the term “retail client” has a specific regulatory meaning and non-bank PSPs (Payment Services Providers) would not generally have procedures in place to categorise their customers on this basis. For customers receiving payment services or e-money, it would be more appropriate for the framework to apply only to customers in respect of which the ‘corporate opt-out’ is not available (i.e. consumers, microenterprises and charities, each as defined under the PSRs). In addition, when the regulatory burden is increased in this way, the likely impact is that firms will seek to create products that are beyond the scope of the regulations.

4. 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?

While we appreciate the intention here is for the proposals to have a broad-reaching effect, we respectfully suggest that the FCA consider the impact on different categories of firms according to the services they provide. As such, we would propose that the new framework has a principle of proportionality built into it, and only apply to payments firms dealing with retail consumers directly. This would support a risk-based approach.

Further, this proposal may impact the contractual relationship between regulated entities. If this were applied to PSPs, it could create issues of legal uncertainty where a PSP does not have a direct contractual relationship with the consumer. This could result in a dual-track system of compliance,

where some activities of a firm would require tracking, reporting and complying on matters where the Consumer Duty applies, and some would not. Such a situation would also be costly to manage.

Moreover, we believe that if this proposal were to be applied to PSPs, its implementation would result in an unnecessary and disproportionate additional burden for PSPs and increase the risk of defensive practices which would not be in the interests of consumers as end-users of payments services.

We would suggest the FCA apply proportionality to its expectations of firms that will be subject to the relevant requirements, with consideration of excluding firms with no connection to the end-user from scope.

Finally, the performance of one payment firm may well affect another further down the value chain, while having no influence over how it provides value to retail users. Holding one firm responsible for the value provided to retail customers by another firm, as implied under section 3.7, seems likely to lead to friction, cost, confusion, and conflict along the value chain.

5. 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 think there should be clear guidance for firms to enable them to offer consumers a choice and allow those consumers to make informed decisions. While we broadly agree with the Consumer Principle, we see the potential for significant ambiguity in the interpretation of some of the more detailed requirements in the proposals; it would be helpful if the FCA could provide more practical guidance on how firms in the payments sector would be expected to implement these.

Option 1 seems to increase the focus on consumers as one of many stakeholders of the firm whereas Option 2 seems to elevate the consumer as the most important stakeholder for a firm. The focus in Option 1 on customer outcomes would allow firms to monitor and manage customer journeys against the intended 'good outcomes' which firms had identified at the start, although these may vary across the industry.

Despite Option 1 gaining some preference within the industry, it needs to provide sufficient certainty for firms to be able to deliver to that standard. Thus, the advantage of Option 2 is that the concept of 'best interest' is well-established by the courts and judicial decisions can help firms at the outset; however, it is not clear whether the Regulator's intention is to follow this established standard or whether the FCA intends to apply a different definition of 'best interest'.

This section contains a lot of information about what behaviours and outcomes we want to drive, but very little on implementation. We seek clear guidance for firms to enable them to offer consumer choice and allow those consumers to make informed decisions.

6. 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?

Broadly yes, we agree. However, it is unclear how the obligation to enable customers to pursue their financial objectives and the rules relating to product manufacture, design and distribution would apply in respect of payments services and e-money. Some of these may not be appropriate for PSPs.

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

We recommend that the FCA gives further consideration as to how these are structured and developed specifically in relation to PSPs (as differentiated from other providers of financial services). In particular, PSPs should not be required to take actions relating to areas over which they could not reasonably be expected to have knowledge or influence. Nor should PSPs have broad positive duties to deliver good outcomes for their customers beyond the scope of services that they have agreed to provide to those customers.

We strongly encourage the FCA to clarify that what is considered to be 'reasonable steps' that must itself be considered in light of the concept of reasonableness that the FCA intends to embed across the whole of the Consumer Duty package. Further, we think the duty should be to 'take reasonable steps' rather than 'take all reasonable steps'. This would align these duties with the reasonableness concept of the regime and with the duties applicable under SMCR. Without such an amendment, we foresee 'paralysis by analysis', which would result in fewer products and services being launched in an increasingly stifling climate for innovators, across a part of financial services – payments – that has hitherto been successful because of its fast-paced approach to product and service innovation.

In our view there is no justifiable reason to impose a higher regulatory burden under the Consumer Duty than that imposed under other relevant areas of regulatory liability within the FCA Handbook, for example under the SMCR Conduct Rules. There is a risk of confusion, in particular in imposing a higher regulatory burden than that under the COCON rules, given that the FCA has proposed to make senior management directly accountable for at least certain aspects of the Consumer Duty package (and it may be that a senior manager is required to be allocated responsibility for oversight of a firm's compliance with the Duty).

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

We appreciate the overlap between the proposed Consumer Principle and care for vulnerable consumers, which is a very important issue for the payment services sector and the financial services sector in general. However, we think that it could be challenging in practice for firms to assess how the firm can demonstrate the customer had appropriate knowledge to make a decision about whether or not to use a particular financial service. We think that the focus should be on ensuring firms are taking reasonable steps to help consumers make informed choices about the services they are offering. However, if a well-informed consumer decides to use a service that may not be in their best interests, firms should not be penalised, nor should the consumer be able to seek redress or compensation for his or her decision.

Once again, the EPA is concerned about how this will work in practical terms. For example, how can a firm effectively assess or demonstrate whether the consumer has behavioural biases or was lacking sufficient knowledge when making the buying decision?

9. 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 think it is important that the FCA aims to avoid duplication of existing principles here. In this respect, it would be helpful to understand what potential harm the proposed Consumer Duty is

intended to address that would not be adequately addressed by Principles 6, 7 and the TCF Outcome. In particular, it is unclear what the FCA's intention is in categorising the Consumer Duty as being a "higher" standard than Principles 6, 7 and the TCF Outcome.

10. 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?

See our response to question 9 above. Further, to the extent Principles 6 or 7 are disapplied where the Consumer Duty is applied, the relevant guidance on Principles 6 and 7 should be replicated for the Consumer Duty where appropriate.

11. 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 think that they do advance the consumer protection agenda as a whole, but we have some significant concerns, particularly in relation to the application to the payment services sector. Further, we question whether the standards on fair pricing and the additional regulatory burdens imposed on certain firms could inadvertently undermine competition in the payments sector. This is of the greatest importance, when the UK is seeking to establish its leadership on the world stage as a source of innovative and progressive payments products and services after Brexit. Should this well-intentioned approach produce a smaller, less progressive payments sector – a likely result if these proposals are implemented in full across all payments firms - albeit one that can demonstrate that no consumers have bought the wrong products, then the cost of achieving this worthy goal is too high.

To summarise, the EPA is confident that the costs of introducing these new principles and duties will be greater than the benefits.

12. 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?

Yes, we agree that this amounts to a duty of care and that the measures proposed would deliver a level of consumer protection equivalent to a duty of care. However, we think that there could be challenges in determining whether a firm has met that standard in relation to a particular consumer. In practice, we think that this will make both compliance and enforcement very difficult and very costly for payments firms and for the FCA.

The terminology used matters a great deal. 'Care' is an emotive word with subjective meaning, i.e. one that is based on or influenced by personal feelings, tastes, or opinions. The EPA believes that the focus should be on the firm creating products or services that the consumer can use safely, but not on ensuring the wider emotional wellbeing of the customer. Should a consumer report that they do not feel cared for in a situation where the product provider has performed consistent with its Consumer Duty, does the consumer have the right to seek redress? If the purchaser reports that they feel upset having purchased the product, even if that product served their needs well, should they be able to complain and seek redress?

We do not consider that the Consumer Duty should be labelled specifically as a 'duty of care',. There is no requirement on the FCA to establish a specific duty of care. The Financial Services Act 2021 does not mandate the FCA to establish a duty of care in name or in substance. It merely requires the FCA to consult on whether it should make rules establishing a duty of care or other rules about the

level of care that must be provided to consumers and to make, before 1 August 2022, such general rules about the level of care that must be provided to consumers (taking into account the outcome of its consultations).

Further, we think that labelling the Consumer Duty as a 'duty of care' may have the effect of confusing consumers and market participants because of potential cross-contamination with duties of care that exist in common law, for example the duty of care owed by bankers to their customers or the duty of care in tort. This means that firms may take the view that they need to have regard to the unspecified and perhaps porous perimeter of a 'duty of care' when considering their contractual and tortious relationships with their customers, beyond the regulatory duties and obligations required. By contrast, regulatory duties are, by and large, fleshed out by rules and guidance rather than through case law. We strongly consider that compliance expectations for firms would be clearer and more realistically achievable through the establishment of a delineation between the common law duty of care and the regulatory Consumer Duty.

The EPA believes that this is at the heart of the weakness of the FCA's proposals in this consultation and why the EPA believes that these proposals will not achieve the desired outcome.

13. What are your views on our proposals for the Communications outcome?

We think that the testing communication requirement should be subject to appropriateness and proportionality tests. E.g. testing a communication may not be appropriate if the need to communicate is urgent or if the firm has a reasonable expectation that the communication will be effective taking account of the nature of the issue communicated, its customers and the services it provides them.

Given that the PSRs and EMRs already have extensive pre-contractual, post-transaction and ongoing disclosure requirements in relation to consumers, we would respectfully submit that the FCA should avoid duplicative or conflicting standards under the proposed Consumer Duty. In addition, we think that it may be difficult for firms and for the FCA to assess compliance with the Communications Outcome in practice. And that this will also benefit larger firms which can spread the cost of testing over large customer bases, rather than smaller firms or those with niche, smaller customer groups, thereby making the smaller and niche-servicing firms less competitive.

We also believe that defining 'fair pricing' will be challenging, such as assessing the price paid by customers on services and products based on the value and benefit those services and products provide. Without further parameters on how firms should establish prices that are fair, they will be unlikely to achieve this 'fair pricing' objective. As a general view, in order to meet the standards required to achieve the outcomes, firms would need to undertake significant reviews of their internal systems and controls, creating new monitoring frameworks and therefore should be given sufficient time to introduce and embed these.

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

We think that the proposals will have a limited benefit to consumers in the payments sector and could be counterproductive in certain areas, especially if applied across all payments firms. See comments above.

15. What are your views on our proposals for the Products and Services outcome?

These proposals seem to be focused on structured investment products and the relevant standards would not be appropriate for payment services or e-money firms.

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

See response to question 15 above.

17. What are your views on our proposals for the Customer Service outcome?

See our responses above, particularly in relation to concerns regarding enforcement.

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

It is unclear to us what these proposals would add beyond existing legal requirements in this area.

19. What are your views on our proposals for the Price and Value outcome?

We think that the proposals on these points – as they currently stand – risk creating an overly rigid framework, which could stifle growth and innovation, and may be detrimental rather than beneficial to the users of payment services and e-money. Firms will need to be able to adapt to changes in market conditions and to react to the (often rapidly evolving) needs of their customers. Price controls are not an appropriate regulatory tool in this context, and it is likely to be extremely difficult for firms or for the FCA to demonstrate compliance or non-compliance with the proposed 'fair value' test.

We also think that there are significant risks that imposing pricing controls could inadvertently undermine competition in the payment sector. The proposals also raise serious questions in relation to how the FCA would assess what is a 'fair price'. And we do not think that this is a determination that would be best or effectively made by a regulator.

At the very least, this is a very difficult concept to deliver, and it directly affects the relationship between benchmarking to ensure commonality and innovation that drives competition. We consider that the FCA must avoid becoming a pricing regulator through these proposals, most importantly to avoid unintended consequences which could, perversely, create outcomes that the FCA wishes to avoid via these proposals. For example, if the FCA was to issue guidance or nudge firms toward flat fees rather than fees based on volume, industry pricing structures will risk becoming regressive to the detriment of less wealthy consumers or those consumers who use products and services or undertake transactions on a smaller scale. Establishing general guidance on appropriate pricing in relation to value is particularly difficult to achieve, and in our view, it is not the role of the FCA to express a preference for specific charging structures within regulatory guidance.

Rather, the right approach would be to leave firms free to judge what constitutes an appropriate pricing model and whether a product is delivering value to consumer, and the consumer to choose whether to buy or use that product or service based on their perception of value. As a general matter, it should be for firms to exercise their discretion as to determining what is fair and reasonable for their customers. Occasionally, however, even this approach is challenging: fair pricing may be even more difficult for innovative products/services as there are no comparisons with which

to compare. But it is much better to allow the market and the consumers in it to determine the fairness of a price of a payments product than a regulator based in Stratford.

We note that the FCA does not intend to use the proposed rule itself to introduce market interventions such as price caps or other price interventions. Where there is a market failure arising from a pricing strategy, it is fair for the FCA to intervene. However, we are very keen to ensure that the FCA does not use the proposals to establish pricing intervention powers or to nudge toward particular pricing models.

Further, the FCA should take care not to conflate the concepts of price and value. Consumers do not always see value in terms of monetary arrangements, and there is a danger of reducing the concept of value to a monetary notion which does not take into account the complexities of human judgment or the different components of value such as service, user-control or feature flexibility, with the FCA becoming the arbiter of good and bad pricing structures under the guise of ensuring value.

We consider that any guidance should remain high level and within a firm's judgment, for example: "firms should price their products and services in a way that reflects their perceived value to consumers".

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

We are concerned that this may trigger severe unintended consequences. We have not seen any examples of EPA members welcoming these four proposals wholeheartedly, and few that believe they will have the desired outcomes.

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

This proposal creates significant risks of legal uncertainty and incentivising overly defensive practices, given the breadth of the principles and the challenges of demonstrating compliance/non-compliance. Private rights of action (PROA) for certain specific identifiable breaches of existing conduct of business requirements may be appropriate. However, general rights of action in relation to broad principles are likely to create uncertainty for firms and their customers and are unlikely to provide better outcomes for consumers.

Furthermore, we believe this could be problematic as it could undermine the status of FOS; FOS was introduced as a redress mechanism for consumers, and therefore we are not sure why this additional right is required and in what circumstances customers would use it. Another issue is the risk of claims management companies seeking to exploit this right by bringing spurious unsubstantiated or poorly articulated claims on behalf of customers, and the appetite for legal firms to encourage actions in order to generate fees, adding both cost and friction to the process of designing, developing and delivering innovative payments products and services.

22. 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 that this could inadvertently lead to defensive practices among firms which could negatively impact consumers. This could dissuade competition and discourage innovation.

If a consumer were to be able to take direct legal action against a firm for its failure to comply with the Consumer Duty, then this could open floodgates to a multitude of spurious claims. See comment under item 21 above. It would also be extremely difficult in practice for a consumer to demonstrate loss had been suffered as a result of a breach of the Consumer Duty, given the issues of legal uncertainty with the proposed principles. That said, it may be equally difficult for firms to refute such claims in certain circumstances for the same reasons, which could create highly subjective and inconsistent outcomes that could be influenced by political considerations or the media. Based on the recent media coverage of APP fraud, banks have a great deal of difficulty in proving a consumer did not take reasonable care, and as a result, are carrying the cost of fraudulent transactions even when the consumer does not take reasonable care.

The EPA believes that this approach would not be in the interests of consumers or firms. Further, the uncertainty likely to be created by this approach would result in defensive practices by firms which may inadvertently undermine efforts to ensure firms act in the interests of consumers. And it could compound the shortage of specialist compliance staff in a market for talent that is already stretched to breaking point, both in the payments industry and at the FCA. See further our comments above.

If failure to comply with Consumer Duty is something for which consumers can sue firms, this could undermine the EPA members' level of support for the FCA's overall proposal, because it would open the door to mass litigation in a way that would create major issues for firms and change the assessment of firms on being in favour of this duty or not.

About the EPA

The Emerging Payments Association (EPA), established in 2008, sets out to make payments work for everyone. To achieve this, it runs a comprehensive programme of activities for members with guidance from an independent Advisory Board of 16 payments CEOs.

These activities include a programme of digital and (when possible) face-to-face events including an online annual conference and broadcast awards dinner, numerous briefings and webinars, CEO Round Tables, and networking and training activities. The EPA also runs six stakeholder working groups. More than 100 volunteers collaborate on the important challenges facing our industry today, such as financial inclusion, recovering from Covid-19, financial crime, regulation, access to banking and promoting the UK globally. The EPA also produces research papers and reports to shed light on the big issues of the day and works closely with industry stakeholders such as the Bank of England, the FCA, HM Treasury, the Payment Systems Regulator, Pay.UK, UK Finance and Innovate Finance.

The EPA has over 150 members that employ over 300,000 staff and process more than £7tn annually. Its members come from across the payments value chain including payments schemes, banks and issuers, merchant acquirers, PSPs, retailers, TPPs and more. These companies have come together to join our community, collaborate, and speak with a unified voice.

The EPA collaborates with its licensees at EPA EU and EPA Asia to create an interconnected global network of people passionate about making payments work for all.

See www.emergingpayments.org for more information. Contact malik.smith@emergingpayments.org for assistance.