

## **Innovate Finance response to "A New Consumer Duty" FCA CP21/13**

### **Q1: 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?**

Innovate Finance is the industry body representing the UK FinTech sector, with over 250 members across the FinTech ecosystem. Innovate Finance supports the development of the UK's world-leading regulatory regime to ensure it strikes the appropriate balance between encouraging innovation and protecting consumers. Regulation should provide effective consumer protection, trust and confidence in the market, and enable innovative products and services that meet consumer needs and strengthen financial wellbeing.

Innovation in financial services creates new business models, greater competition, and choice for consumers and businesses. Within the drive for innovation, consumer protection is paramount. With a stiffening of international competition, the UK cannot afford to lose its reputation as a jurisdiction that leads in financial innovation; consumer protection in the UK should be developed in a way that supports this aim.

The Consumer Duty needs to be developed in a way that: provides an ongoing basis for protecting consumers as technology continues to transform financial services; is proportionate, maintaining UK competitiveness and not acting as a barrier or disproportionate burden on startups and scaleups; and takes a 'digital by default' approach<sup>1</sup> to design and delivery, that enables outcomes to be achieved through digital channels (e.g. communication and information, customer service).

There is an opportunity for the UK to leverage innovation across FinTech as an exportable commodity, strengthening the UK's global competitiveness, and laying the groundwork for future success if the regulatory settlement is designed to meet the needs of consumers and businesses alike.

The context for the development of Consumer Duty includes;

- HM Treasury's work on the UK's future regulatory framework, where Innovate Finance and many other organisations have called for the principles of proportionality and global competitiveness to be incorporated into the remit of regulators. As part of this, Innovate Finance urges the FCA to conduct a specific 'startup' and 'scaleup' test of the Consumer Duty proposals to ensure they are proportionate and do not unduly impact organisations with less resources and / or act as a barrier to competition and market entry.
- The Kalifa Review of UK FinTech and in particular the FCA's commitment to implement proposals for a regulatory 'scalebox' and also to introduce a 'Regulatory

---

<sup>1</sup> i.e. To use the UK Government definition of 'digital by default: "digital services which are so straightforward and convenient that all those who can use digital services will choose to do so, while those who can't are not excluded."

Nursery'. These proposals are intended to provide more hands-on and supportive regulatory engagement with innovative companies at the startup and scaleup stages and these principles should be applied to the Consumer Duty. The FCA should ensure that smaller, innovative providers have dedicated support and that FCA account managers agree a 'regulatory pathway' for each firm, which sets expectations proportionate to their stage of development.

- Digital by default: the Consumer Duty should allow for outcomes to be delivered by digital means, including digital communications and information, with AI and robo-advice, use of data and digital decision-making tools by consumers. It should not require face-to-face or document-based solutions.
- As innovation drives new products, it is likely that the regulatory perimeter will need to be expanded. Providers generally welcome this as a way of providing greater clarity and consumer confidence – provided there is a smooth transition and new authorisation processing is properly resourced. The Consumer Duty should be designed and implemented in a way that makes this easier and less complex. The Consumer Duty needs to be compatible with new regulatory regimes being developed, for example for 'Buy-now, pay-later' (also known as 'deferred payment credit') products, as well as providing an agile basis for future product innovations and wider regulatory developments that will affect consumer interests, for example in the field of climate change.

The Consumer Duty will interplay with the work of the Financial Ombudsman Service. Coordination will be needed to ensure consistent approach across the FCA and FOS to avoid different interpretations of Consumer Duty. Since the FOS will be applying and enforcing these rules in practice, FCA should be precise with its rules and guidance, including giving some clear examples of negative scope (i.e. "the Consumer Duty will not require firms to do X") in order to help put this into context.

An outcome-based approach to consumer protection has the potential to provide the flexibility to continue to support innovation in financial services. This will need to avoid unintended consequences and work in a way that does not create barriers to entry or hamper innovation.

**Scope:**

Our members also want to see clarity on the scope of the proposals: it clearly applies to retail consumers, but it is not clear whether it would apply to SME / small business customers. It is not clear whether "retail clients" applies to SMEs or not.

Arguably the level of protection provided by the Duty may be deemed unnecessary for all but the smallest of SMEs, considering their relative sophistication compared to many consumers. However, if it is to apply to SMEs it would be significantly clearer if the scope for businesses was limited to those activities within the regulatory perimeter. This would prevent creating grey areas where some regulated firms are potentially covered by the Duty even for activities which are unregulated (like business lending).

The priority here is clarity: exactly who the Duty will apply to, and under what circumstances.

This will reduce the potential for confusion and misunderstanding, both for customers and firms.

**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?**

In principle, Innovate Finance considers this structure to be sensible and appropriate. However, the FCA should take care to ensure that it does not result in confusion and lack of clarity as to the scope and effect of the proposed duty.

**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?**

Either option will require more granular guidance to ensure clarity and consistency. This will be particularly important in ensuring a consistent approach with other bodies such as the Financial Ombudsman Service (and for the courts should a PROA be introduced subsequently – but note Innovate Finance has significant concerns about a PROA, see below).

Innovate Finance considers that in a choice between the two options, Option 1 ('A firm must act to deliver good outcomes for retail clients') is preferable to Option 2 ('A firm must act in the best interests of retail clients').

Option 1 is explicitly outcome focused. The FCA should however make clearer, through the rules and outcomes, that firms will be judged primarily on the actions taken in order to achieve outcomes ("act to deliver good outcomes") and not on the outcomes themselves. In other words, a poor outcome for a particular customer should not be a breach of the Principles. For example, if the firm had taken reasonable steps to achieve good outcomes and the poor outcome was not reasonably foreseeable or reflected a transactional risk accepted by an informed consumer.

Option 1 potentially has less scope for applying disproportionate expectations.

Option 2 implies that the customer has little or no responsibility for making decisions; the focus on acting to achieve outcomes in Option 1 better reflects that final decisions are taken by the customer and that the outcomes can be influenced but not always controlled by the firm.

**Q7: Do you agree with these early-stage indications of what the Cross-cutting Rules should require?**

The application of reasonableness needs to be applied in conjunction with other measures to support financial services startups and scaleups - notably the 'Regulatory Nursery' and 'Scalebox'. It can be difficult for smaller and scaling firms to take a view of reasonableness, given it is a qualitative judgement. FCA account managers or advisers should provide support and advice on what is expected, based on dialogue with the firm. This approach also needs to be taken with product innovation, to reach a view of reasonableness based on prior and ongoing dialogue with the business. These individual approaches to reasonableness should be shared with the FOS to ensure consistency.

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

Some of our members have raised concerns that potentially the focus could end up being on avoiding breach (by acting conservatively) rather than necessarily improving levels of care or seeking to innovate. The approach of FOS is also an important factor here and could further stifle innovation. This is likely to be exacerbated if a PROA is introduced.

**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?**

*[Principle 6: Customers' interests - A firm must pay due regard to the interests of its customers and treat them fairly.*

*Principle 7: Communications with clients - A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and accurate.]*

There should be no duplication or potential overlap of principles. Disapplying Principle 6 and 7 would seem a sensible approach to avoid confusion and provide greater clarity and consistency.

**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?**

These proposals will only advance competition objectives if they are implemented in a way that ensures that smaller firms - startups and scaleups - and firms introducing innovations do not suffer a disadvantage compared to established incumbents (providing established, traditional services and with large resources and compliance teams). The proposals must work with the grain of supporting innovation scaleups. This means:

- Building this into an effective and properly resourced 'Regulatory Nursery' and 'Scalebox' approach, which enables firms to navigate the Consumer Duty and is based on ongoing dialogue to ensure a proportionate approach to reasonableness.

- Test different approaches to the Consumer Duty when new products are tested in the FCA Sandbox.
- Allow for different ways of achieving the same outcome.
- Recognise 'digital by default' methods of delivering customer outcomes.
- Ensure consistency across other parts of the regulatory regime, including the FOS.

**Q13: What are your views on our proposals for the Communications outcome?**

Innovate Finance believes that B2C FinTech businesses have a proven track record of communicating more clearly, more succinctly and more quickly than incumbents. Technology-based communications and tools can facilitate decision-making and enable proportionate steps to review and, where appropriate, test and adapt communications to ensure they are likely to be understood by the target consumers.

What will be critical here is a clear commitment by the FCA that digital communications, including those based on AI and robo-advice, can deliver and achieve the communications outcome, and that supervisors do not expect 'real life' or face-to-face advice or communications to meet the requirements.

**Q15: What are your views on our proposals for the Products and Services outcome?**

As stated above, Innovate Finance believes that FinTech businesses have a proven track record of designing and delivering products and services to benefit customers. FinTech businesses communicate more clearly, more succinctly and faster than incumbents. It will be important to recognise that design and review can include real time testing and data.

It will be essential to clearly differentiate between new product launches and iterative builds and developments. Innovative providers make small, iterative changes to products and services on a daily basis. The rules and guidance for products and services should set out a proportionate approach to such iterative product development. A proportionate approach means that iterative builds and developments should not be subject to the same requirements as the launch of a significant new product or service.

A proportionate approach should also recognise that it should not be necessary to always suspend a product if it is found to be not meeting the needs of the market; iterative development, design adaptations and testing should be permitted too.

More detailed guidance will be needed on questions such as what constitutes measures such as 'a sizable proportion of customers' or a 'significant sum'.

**Q17: What are your views on our proposals for the Customer Service outcome?**

Innovate Finance supports measures to make it easy to exit a service and switch suppliers, enabling competition. What will be critical here is a clear commitment by the FCA that digital

customer services can deliver and achieve the outcome without reliance on 'real life' contacts.

**Q21: Do you have views on the PROA (Private Right of Action) that are specific to the proposals for a Consumer Duty?**

A private right of action would open the door to courtroom disputes about the Consumer Duty. Such litigation could be complex and costly for all parties. This would create a disproportionate cost for startups and scaleups.

Firms could also face an increased risk of collective actions, in circumstances where complaints about a breach of the Consumer Duty could readily arise across entire product or consumer classes.

Claim management companies could also create significant costs that damage smaller providers, even if the cases are not upheld.

In addition, PROA would entail courts interpreting the principles and making judgements that are (a) technically complex and (b) inconsistent with the approach taken by the FCA.

Firms need certainty that the FCA approach will not be second guessed and reinterpreted - whether by FOS or by courts under PROA. Innovate Finance is concerned that PROA could significantly deter product innovation and competition by startups and scaleups and would add a layer of uncertainty to the Consumer Duty.

**Q26: What unintended consequences might arise from the introduction of a Consumer Duty?**

**Consumer outcomes:** If the new duty is introduced in a way that imposes significant additional burdens on activities within the regulatory perimeter, it runs the perverse risk of incentivising firms to carry on unregulated activities or structure their activities to avoid regulation in the UK. This could lead to increased risk of consumer harm.

**Stifling innovation:** Another possible negative outcome is that regulated products will be designed to minimise risk and avoid having to give advice, thus stifling innovation. Access to more complex products may become the preserve of those who have access to independent advice or are classed as 'sophisticated', potentially damaging efforts to increase financial inclusion. There is a risk that firms will also increasingly want to serve only low-risk customers, leaving vulnerable consumers marginalised because they are considered higher risk.

If the approach is not proportionate, and does not provide support for startups and scaleups, competition and innovation will be curtailed, to the detriment of the consumer.