



Institute
and Faculty
of Actuaries

Discussion Paper 18/5 on a Duty of care and potential alternative approaches

IFoA response to the FCA

2 November 2018

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

We strive to act in the public interest by speaking out on public policy issues where actuaries have the expertise to provide analysis and insight. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.



Consumer Insight
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

2 November 2018

Dear Sir / Madam,

Draft response to FCA Discussion paper DP18/5 on a duty of care and potential alternative approaches

General Comments

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FCA's Discussion Paper DP 18/5 on a duty of care and potential alternative approaches.
2. The IFoA is the UK's only chartered professional body dedicated to educating, developing and regulating actuaries based both in the UK and internationally and has around 32,000 members. The consultation has been considered and reviewed by our Finance and Investment Board.
3. Although DP 18/5 is applicable to all financial firms, the context for it includes ongoing concern about the culture within banks and the behaviour of banks towards their customers. The majority of the IFoA's members are involved in insurance and pensions activities, but the IFoA supports an active Banking Member Interest Group, whose goals include building a knowledge base of actuarial techniques used in banking, and helping interested members to move into banking.
4. The IFoA believes that there is a strong case for introducing a duty of care as a positive obligation, as opposed to a prohibition or fiduciary duty. Our recommendation reflects the need to reverse the erosion of trust in banks caused by various scandals, such as PPI mis-selling, derivatives mis-selling, Libor manipulation and, more recently, RBS's Global Restructuring Group. These events occurred despite the *Treating customers fairly* initiative championed by the FCA's predecessor the FSA. That initiative, and the FCA's Principles for Businesses, are necessary and important, but in our view further safeguards are needed. We believe that a duty of care would make banks and bank employees more conscious of their duty to their customers, and would address public frustration that few bank employees have been sanctioned. While recent concerns have related to the behaviour of banks, we think that that the duty of care should apply to financial firms and their employees in general.
5. We suggest that the duty of care should be in the form of a principle, with a supporting standard explaining its application to different products and customer groups. The standard should also be applicable to situations which cannot be anticipated. This last consideration is important given the rapid development of new technologies which may transform many areas regulated by the FCA, for example, through innovative products and services based on Open Banking. As we describe below, we believe a duty of care carefully structured in this way need not increase complexity or reduce innovation.

London 7th Floor • Holborn Gate • 326-330 High Holborn • London • WC1V 7PP • **Tel:** +44 (0) 20 7632 2100 • **Fax:** +44 (0) 20 7632 2111

Edinburgh Level 2 • Exchange Crescent • 7 Conference Square • Edinburgh • EH3 8RA • **Tel:** +44 (0) 131 240 1300 • **Fax:** +44 (0) 131 240 1313

Oxford 1st Floor • Park Central • 40/41 Park End Street • Oxford • OX1 1JD • **Tel:** +44 (0) 1865 268 200 • **Fax:** +44 (0) 1865 268 211

Beijing 6/F • Tower 2 • Prosper Centre • 5 Guanghua Road • Chaoyang District • Beijing China 100020 • **Tel:** +86 (10) 8573 1000 • **Fax:** +86 (10) 8573 1100

Hong Kong 2202 Tower Two • Lippo Centre • 89 Queensway • Hong Kong • **Tel:** +11 (0) 852 2147 9418 • **Fax:** +11 (0) 852 2147 2497

6. We suggest that the object of an employee's duty of care should be interpreted in a wide sense. Depending on circumstances, it might encompass not only the client, but also, for example, colleagues, shareholders, lenders, or broader society.
7. In our view there are dangers in regulation that relies largely on either rules or principles. Rules can be inflexible, while principles may be difficult to interpret and enforce. Empirical evidence suggests that a balanced combination of the two is most effective, and this is the approach that the IFoA has adopted in its regulation of actuaries (see Question 1 below).
8. Although we think that there is a strong case for introducing a duty of care as a positive obligation, we note the FCA's comment, on page 18, that it has no power to introduce a statutory New Duty, and that any form of statutory New Duty would require a change to primary legislation in Parliament. Scheduling such legislation might be challenging given the demands of Brexit, but if time could be found it might not be difficult to get a Bill passed, given that the government established the Parliamentary Commission on Banking Standards, and that the opposition has been talking about a 'greed is good' culture within business.

Responses to specific 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 change(s)?

We believe (as argued above), that there is normally benefit in having a mix of principles and rules in a regulatory framework.

We agree with the argument in the paper that the FCA's Principles for Business cover issues that would be in a duty of care - such as customers' interests (Principle 6), communications with clients (Principle 7), conflicts of interest (Principle 8) and customers: relationships of trust (Principle 9). (See Principles on pages 10 and 11.)

However, as the FCA says on page 24 of *Our future Mission*, "the FCA Principles are themselves rules". We therefore think that there is indeed a regulatory gap, and that it would be useful to have, above the FCA Principles, a duty of care. This would be an overarching principle (i.e. an expression of expected behaviour) for a duty of care as a positive obligation (as defined in the box on page 5).

The principle would apply to all employees of financial firms (not just those in the SM&CR). It could require an appropriate degree of care to be given for different products and for different customer groups (including vulnerable customers). This could be explained in a standard supporting the principle. The standard could include separate sections for different kinds of financial firm. For example, the section for banks could be written by the Banking Standards Board and/or the Chartered Banker Institute, working with the FCA.

The approach we suggest would avoid the need for a complex set of new rules, to cover all possible circumstances.

If a New Duty is introduced as a principle with a standard, we suggest that the principle and standard should be consistent with equivalent principles and standards applicable to professionals already working in financial services (such as accountants, actuaries and lawyers), and should be appropriate for firms in insurance and fund management as well as for banks.

We can illustrate this by reference to the IFoA's approach to regulating actuaries. The Actuaries' Code sets out key principles that all members are expected to abide by, including integrity, competence and care, and impartiality. Failure to observe the Code may be taken into account by a Disciplinary Panel. In addition there are two kinds of Standards: Actuarial Profession Standards (APSs), which apply to all members regardless of location, and Technical Actuarial Standards (TASs) (set by the Financial Reporting Council (FRC)) which must be followed by those carrying out work in

the United Kingdom. Finally, there is non-mandatory guidance to assist members to meet their professional obligations.

The requirements that the IFoA imposes on individual members are closely aligned with the FCA's Principles for Business. In addition, we have established the Quality Assurance Scheme, a voluntary global accreditation scheme for organisations that employ actuaries, and this promotes outcomes which are consistent with the Principles for Business.

If you believe that there is, please explain what change(s) you want to see. We are particularly interested in your views on:

i. The types of harm and/or misconduct any changes would address.

We think that the duty of care principle that we propose should apply to all employees of financial firms and in all circumstances that relate to personal and SME customers (including product design, sales and service).

ii. Whether a New Duty should be introduced and, if so, what form it should take.

As explained in our general comments, we think that there is merit in giving consideration to the introduction of a New Duty as a principle and standard, supporting a positive obligation.

iii. What additional consumer protection and benefit this would provide, above the current regime (including over and above the existing implied term in the CRA for reasonable care and skill).

As more generally for principles versus rules, we think that the New Duty, as a principle, would encourage employees of financial firms to think about the application of the New Duty in individual situations, rather than to rely on 'tick-box compliance' with the rules - or, even worse, to exploit loopholes in the rules.

iv. How a New Duty could and should act to mitigate or remove conflicts of interest, including the types of conflicts which exist in the provision of financial services?

We think that the New Duty would reinforce Principle 8, within a broader context explained in the standard that we have proposed.

v. Whether a New Duty could reduce complexity and bring greater clarity, or whether it could result in an additional layer of regulation and make it more complex, and, if so, how?

We think that a New Duty as a principle would be clear and easy to understand, and the standard that we propose could explain its applicability in different situations. We believe that, if the New Duty were to be introduced not as a principle but as a rule, that rule would have to cover a range of different situations, and the new rule would overlap with existing rules.

vi. Whether other alternatives could help address any gaps, for example, extending the clients' best interests rule to different activities.

We think that, if the New Duty were added to Principle 6 (customers' interests), it might well get lost, and be seen as merely a semantic change. We think that the introduction the New Duty as a principle, with a supporting standard, would get much more attention from banks and other financial firms, and from their customers and employees. That is, we agree with the sentiment of the first full paragraph on page 18, that a New Duty as a principle, with a supporting standard, "would be taken more seriously by firms and improve their culture and treatment of customers".

vii. Whether we should introduce more detailed rules and guidance, and, if so, what specific rules and guidance are required?

As explained in the Discussion Paper, there are already adequate rules. We think that more rules would add to complexity and might lead to confusion. We think that it would be more effective to introduce the New Duty as a principle and standard, as we suggest above.

viii. Whether the scope of any changes should differ between markets and whether it should include wholesale transactions.

Our preference would be that the New Duty should be applicable to all employees of financial firms in all circumstances, as the elements of The Actuaries Code are applicable to all actuaries. However, it might be that the duty of care principle is most relevant where there is an information asymmetry between the bank and its customer. An unintended consequence of extending the scope to wholesale transactions could be that sophisticated customers might unfairly seek compensation on the grounds that insufficient duty of care had been shown to them.

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?

We think that the New Duty would make employees more careful about their treatment of customers, taking account of their individual needs. As noted in our answer to Question 5, we think that the New Duty would lead to firms being more diligent in seeking to avoid harm to customers, since customers might claim redress under the New Duty. Whilst we believe a New Duty would lead to improved conduct, we feel that it can only be one element of a regulatory framework. Achieving a significant improvement in behaviours will therefore require a multi-faceted approach to regulation, and continuing cultural change at institutions.

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?

We think that the New Duty, in the form that we suggest, would support better outcomes for customers. It would cause customer-facing employees to understand and respond better to the needs of customers in different product areas, and to the needs of vulnerable customers. In addition, it would cause employees designing products and processes to check that they are easy for customers to understand and easy to use.

We recognise that a New Duty is not a panacea. For example, it is possible that a minority of employees may misinterpret it as a requirement for negative behaviours, such as defensive attitudes, blocking innovation, or restricting customer choice in some areas. However, we think the benefits of a well-constructed duty of care principle and standard will outweigh any negative outcomes.

We think that the New Duty would also help to restore trust in banking. Because the New Duty, in the form that we suggest, would apply to employees (in the way that professional codes apply to members of the profession), it would help to address the public concern that, despite the failure of some banks followed by a series of problems in banking (including PPI mis-selling, derivatives mis-selling, LIBOR manipulation and, more recently, the activities of RBS Global Restructuring Group), very few employees have been held to account, by their firm or by the FCA.

The FCA has fined firms (sometimes, as for PPI, heavily), but it is not clear that corporate fines have changed individual behaviour within firms for the better. For members of a profession, the fear of being sanctioned (and even struck-off) may well have a significant positive effect on behaviour.

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?

We accept the FSA's rationale for not allowing right of action in relation to the Principles, and the subsequent views of the Law Commission, as explained on pages 30-31. In any case, most retail customers would not have the resources to take their complaint to court.

As stated on page 28, "Consumers are likely to be more willing to engage with financial services if they are confident that they can challenge unfair treatment and obtain a remedy". We think that, in general, the best process for most consumers is to make a complaint to the firm and, if not satisfied with the response, refer it to the Ombudsman. If a New Duty is introduced, and consumers know that both the firm and the Ombudsman would have to take account of it when considering complaints, it should make customers more confident about engaging with financial services.

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?
If so, please set out the ways in which a New Duty would improve the current regime.**

If a New Duty were to be introduced:

- Firms would have to take account of it when considering customers' complaints (see bottom of page 28); and
- The Ombudsman would take account of it when resolving disputes, as explained on page 29.

So, in the period ahead of the New Duty being introduced, it seems likely that firms would be concerned that these two factors would lead to them having to make greater payments for redress, and that this would incentivise them to take actions to prevent harm.

If you wish to discuss our response in more detail, please contact Matthew Levine, Policy Manager (Matthew.Levine@actuaries.org.uk or 020 7632 1489).

Yours sincerely,



Jules Constantinou
President, Institute and Faculty of Actuaries