The New Consumer Duty

Key considerations and challenges for Payment Service Providers

The Financial Conduct Authority ('FCA') published the finalised Consumer Duty rules ('the Duty') in July 2022. The Duty sets out the FCA's expectations on higher standards of consumer protection across financial services – where firms are required to put customers first.

The Duty applies to regulated and ancillary activities of all firms authorised under Financial Services and Markets Act 2000 ('FSMA'), Payment Services Regulations 2017 ('PSRs') and E-money Regulations 2011 ('EMRs'). The payments and e-money sector is brought under the scope of Consumer Duty for products and services affecting both prospective and actual retail consumers*.

The Duty calls for all firms including payment service providers ('PSPs') to develop a consumer outcomes-focused mindset informing how they help ensure consumers are adequately equipped to make effective decisions, and ensure product offerings are fit for purpose and offer fair value to consumers. The Duty is applicable across the payments value chain, irrespective of whether a PSP holds a direct relationship with the end consumer.

This short paper highlights key considerations and challenges that PSPs face in not only achieving but also evidencing compliance with the Duty.

The Consumer Duty

The Consumer Duty is a package of measures comprising:

1. A new Consumer Principle (Principle 12) that provides a high-level expectation of conduct.
2. A set of overarching cross-cutting rules which develop and amplify the standards of conduct that the FCA expects under the Consumer Principle.
3. A set of four outcomes and the respective rules and guidance which sets more detailed expectations for a firm's conduct. These four outcomes represents the key elements of the firm-customer relationship.

The Duty and payment firms

The Duty presents new questions and challenges that all firms will need to overcome in order to demonstrate compliance by the implementation dates: 31 July 2023 for open products and services and 31 July 2024 for closed product and services.

PSPs, regardless of whether they hold a direct relationship with the end consumer or not, will need to demonstrate this outcome-focused look-through required by the Duty, in what can potentially be a very disintermediated payments value chain.

In a highly innovative, diverse and competitive market with complex payment product/service offerings and business models, PSPs face a complex task in evidencing target market understanding and adequate support that is provided to consumers, not only at point of sale ('POS') but throughout the whole product/service lifecycle.

Defining the scope: a strong first step is key to success

The Duty applies to regulated and ancillary activities of PSPs. Ancillary activities in the context of payments involve those necessary for the provision of regulated payment services, even if such activities are not themselves regulated. See case study 1 for an example.

Case study 1

Mobile wallets: defining their role in the value chain

Mobile wallets that facilitate transactions / purchases by storing a user's card details are unlikely to be a standalone regulated service.

Despite this, PSPs will need to establish whether wallets fall under the Duty by assessing, on a case basis, whether their wallets are necessary for the completion of regulated payment services.

The Duty applies to business conducted with "retail customers". Under the payments and electronic money regime, this means consumers (defined under the PSR 2017 and EMR 2011 as individuals acting for purposes which are outside their trade, business or profession), micro-enterprises (enterprise whose annual turnover and/or balance sheet total does not exceed €2 million (or £ equivalent) and employs fewer than 10 people) and small charities with a below £1 million turnover.

Case study 2

Merchant acquirers: defining retail customers

Acquiring firms commonly contract with merchants of different business sizes. The new regime presents the challenge for acquirers to, where reasonable, equip themselves with management information ('MI') that allows them to identify on an ongoing basis microenterprises who they may be dealing with and are therefore captured under the new Duty. Alternatively, acquiring firms might simply opt for bringing all merchants into scope of the Duty for implementation ease.

Navigating through complex payments value chains

The payments value chain is prone to complexity with manufacturer/distributor relationships overlayed with regulated and non-regulated entities providing regulated and/or ancillary activities.

PSPs will all be required to agree and clearly document their roles and responsibilities under the Duty to ensure that they are met. This is a clear shift from the incumbent regulatory regime. Furthermore, the evidential requirements may call for PSPs to revisit their outsourcing arrangements to ensure this effectively enables them to demonstrate good customer outcomes across the payments value chain.

Case study 3

Technical service providers (TSPs): avoiding harm

Although TSPs' services fall outside the scope of the PSRs, PSPs have always been ultimately liable for such services. Under the Duty, where an activity is outsourced, the PSP remains liable for any customer harm caused by such activity.

Contextualising the above with SCA, where the lack of authentication options causes unnecessary friction and consequential transaction abandonment at checkout stages, retail customers such as small e-commerce merchants may be exposed to harm. This means that PSPs now need to evaluate whether their SCA arrangements are causing customer harm, including in instances where this service is being outsourced to a TSP.

Customer base and target market: vulnerability in context

Addressing the particular risks and needs of customers with signs of vulnerability is a significant area of importance under the Consumer Duty.

In our view, some of the features inherent in payments firms, such as the adoption of digital-only service channels or the provision of services to customers not targeted by incumbent banks, can trigger important issues to be considered by PSPs. See case study 4 for an example.

Case study 4

Money remittance firms: addressing vulnerability by design

Money remittance services may have higher exposure to risks relating to customer vulnerability. For instance, such services may be used by immigrant workers providing financial support to their families overseas or retirees purchasing a property to move abroad.

Firms operating in this sector should take into consideration the nature of money remittance transactions and ensure that, for example, the information they hold on their customers and their support arrangements are effectively avoiding harm.

Overlaying the Duty with other regulators' agendas

PSPs also need to pay consideration to the relevant requirements set out by other regulators.

Case study 5

Preventing Authorised Push Payment ('APP') Scams

APP scams are a key area of concern among UK authorities and this can be seen in the form of the Payment Systems Regulator's agenda on the topic, particularly around the proposals for mandated reimbursement of victims.

From a Consumer Duty perspective, PSPs are expected to take proactive action to understand and give effect to their role in tackling APP scams and ultimately preventing the risk of consumer harm. As guided by the FCA, this can take shape through assessing whether payment journeys use appropriate friction, as well as whether sufficient warnings are in place.

The practical implication is that PSPs must pay regard to the new consumer Duty, including where they are pursuing compliance with regulatory activity initiated by other regulators than the FCA.

Governance and accountability

Payments firms are not subject to the Senior Managers and Certification Regime ('SM&CR', a framework that ensures that the most important responsibilities within certain regulated firms are assigned to specific senior individuals who can be held fully accountable for their decisions and the standards of their firms). In spite of that, PSPs still need not only to ensure they have appropriate management oversight and accountability for the firm's compliance with the Duty, but also that their staff are acting in accordance with Duty's provisions.

In practice, this means that senior managers of PSPs are responsible for assessing whether their activities are delivering good outcomes for customers which are consistent with the Consumer Duty. This is a fundamental change from the relatively prescriptive characteristic of payments rules to date.

By doing so, PSPs will need to determine what type, frequency and level of granularity of MI their board (or equivalent governing body) will need to engage with to be able to adequately discuss, challenge and have assurance that the firm complies with the requirements of the Consumer Duty on an ongoing basis. Challenge from the board also enables a culture that focuses on the delivery of good customer outcomes.

Furthermore, the role of the Consumer Duty champion in ensuring that the Duty is being discussed and raised regularly in all relevant discussions is key in supporting firms to challenge themselves whether they are in delivering good outcomes for customers or not.

So, what's the conclusion?

The Consumer Duty is a significant regulatory requirement that will greatly impact firms operating within the payments sector.

Under the Duty, the FCA expects payments' retail customers to receive good outcomes. Therefore not having a direct relationship with customers is not a 'get out of jail free card'.

Whilst firms will be required to allocate resources to ensure compliance, the Duty also brings the opportunity for firms to take a step back and consider how their range of products and services are associated with sustainable business models, and are properly aligned with their values and strategies. This ultimately allows for better informed business decisions.

A fundamental starting point for payment firms after having approved their implementation plans is to carefully assess and conclude where they sit within the payments value chain in light of the Duty. The conclusions will guide all further work.

Next steps

PSPs are expected to have already obtained Board (or equivalent governing body) approval for a Consumer Duty implementation plan and to have taken active steps towards the following implementation milestones.

The next deadline (end of April 2023) is fast approaching: products and services manufactures must have completed their reviews to meet the outcome rules while providing the necessary information for distributors to make their necessary adjustments ahead of the **effective date for open products and services (31 July 2023)**.

Questions to consider...

1. Are you confident in your understanding of your roles and responsibilities under the Consumer Duty?
2. Do you know the target market for whom you are providing the product and/or service to?
3. Are your MI and information sharing arrangements sufficient to meet the requirements of the Consumer Duty?

We're here to help

Our cross disciplinary teams are supporting some of the largest Financial Services clients in the UK. We understand regulatory expectations and how to execute them. We also understand the challenges faced by many firms in meeting these requirements.

We will be hosting a roundtable for the Payments industry focusing on Consumer Duty in the coming months. If you would like to attend this event or discuss any of the matters highlighted in this article in more detail, please do not hesitate to contact us.

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