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Consumer duty part 2 - 'The drill-down' into the 'cross-cutting' rules

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This article is the second in a series to help firms take a practical approach to complying with the 'cross-cutting rules' within the new 'Consumer Duty' (CD) framework.

What are the ramifications for 'foreseeable harm'?

The article summarises what it seems the Financial Conduct Authority (FCA) is seeking to achieve from the applicable rules (section 2 below) and potential complications arising from legal considerations (section 3).

1. 'Foreseeable harm' as a component in the 'consumer duty'

On 31 July 2023 the CD rules are due to take effect. Their cornerstone will be Principle 12': "A *firm* must act to deliver good outcomes for *retail customers*" (not just "consumers").

The principal framework is set out from PRIN 2A.1 (accessible via the FCA Handbook's 'timeline' feature).

PRIN 2A includes the "Cross-cutting obligations" including at PRIN 2A.2.8 R: "A *firm* must avoid causing foreseeable harm to *retail customers*" (the "**foreseeable harm rule**").

2. What is foreseeable harm?

'Foreseeable harm' is not defined in the rules or guidance at PRIN 2A, although there is text on what 'causes' foreseeable harm (see PRIN 2A.2.9 R), how it can be 'avoided' (see PRIN 2A.2.10 G), and the circumstances in which the foreseeable harm rule may or may not apply (see PRIN 2.A.12 – 13 G).

However, there is non-Handbook guidance in FG22/5 (published alongside PS22/9, which set out the new CD rules and gave feedback on the prior (CP21/36) consultation) as to what foreseeable harm is:

"Whether harm is considered foreseeable would depend on whether a prudent firm acting reasonably would be able to predict or expect the ultimately harmful result of their action or omission in connection with the product or service ...

1. consumers being unable to cancel a product ... because the firm's processes are unclear ...
2. products and services performing poorly where they have not been appropriately tested in a range of market scenarios ...
3. [the distribution] of products ... to customers for whom they were not designed ...
4. consumers incurring overly high charges on a product because they do not understand [its] charging structure or how [this structure] impacts on the [product's] value ...
5. consumers with characteristics of vulnerability being unable to access and use a product or service properly because [of unsuitable] ... customer support ...
6. consumers becoming victims to scams ... due to a firm's inadequate systems [which should] detect/prevent scams or [give effective] ... scam warning messages ..."

FG22/5 also expands upon the concept of 'foreseeability':

> "... firms are only responsible for addressing the risk of harm when it is reasonably foreseeable at the time, considering what a firm knows, or could reasonably be expected to have known. This will depend in part on the information the firm collects as part of its business, and this in turn will depend on the scale, service offering and capabilities of the firm. However, we expect all firms to collect enough information to be able to act to avoid causing foreseeable harm."

It also seems that the FCA will be looking to enforce compliance with the foreseeable harm rule by reference to the risk of harm, whether or not harm in fact occurs:

> "Firms should proactively consider how consumers' behavioural biases, such as inertia, might lead their products or services to cause foreseeable harm ...
>
> ... Firms should identify the potential for harm that might arise if their products and services change or their understanding about the impact on customers changes and take appropriate action to mitigate the risk of actual or foreseeable harm ...
>
> The regular reviews we require of firms provide an opportunity to identify any new or emerging harms. Firms will also become aware of sources of harms (for example through consumer complaints, management information (MI), press reporting, and FCA supervisory focus and communications such as 'Dear CEO' letters) ..."

FG22/5 also sets out scenarios which give practical illustrations of the risk of foreseeable harm and how to prevent it, including one which has potential significance across a range of markets, including retail insurance, lending and investments:

> "A ... manufacturer has a distribution strategy of non-advised tele-sales by third parties. Over time, the firm found that 40% of its contracts sold in this way were cancelled within the first year. This could indicate that product was being sold widely outside the target market and that the customers affected are suffering harm.
>
> ... The manufacturer could investigate the causes behind the high cancellation rates and consider whether [for instance] it needs to amend the target market, provide additional training to some of its distributors, or amend the information it provides for prospective customers ..."

A further factor in potential foreseeable harm is the 'withdrawal' of a product. Sectors for which the above has particular significance could include consumer lending (e.g., via the non-renewal of credit facilities) and general insurance (e.g. via the non-renewal of policies of heads of cover, such as where there has been a reduction in underwriting appetite and capacity on insurers' part):

> "... if a firm withdrew a product or service abruptly or without considering the effect on the consumers who are impacted this could cause foreseeable harm ...
>
> Where a firm is planning to alter or withdraw a product or service, they should consider whether it could lead to foreseeable harm for their customers or a specific group of customers (such as customers with characteristics of vulnerability) and take steps to mitigate the impact of the potential harm. This could mean not withdrawing the product or service too abruptly, allowing time and support for customers to find suitable alternatives and ensuring that they communicate any changes in a timely, clear and sensitive manner. This should include setting out what it means for the consumer, communicating alternative solutions, and the consequences to any consumers of not acting ...
>
> Firms should engage with us if they are considering withdrawing or restricting access to products or services in a way that will have a significant impact on characteristics of vulnerability or on overall market supply ..."

3. Legal and enforcement ramifications

'Foreseeable harm' is a key concept in the law of negligence, and especially negligent misstatement (see e.g. Halsall v Champion Consulting Ltd [2017] EWHC 1079 (QB) citing 'Charlesworth and Percy on Negligence'). It continues to involve extensive legal analysis and argument.

The contentious aspects of foreseeable harm tend to involve whether a particular form of harm can be said to be capable of being foreseen in a particular matrix of circumstances – for instance: "a hypnotist had no reason to foresee a risk that his subject might suffer schizophrenia or other lasting physical effect from hypnosis" (Charlesworth, summarising *Gates v McKenna [1998] Lloyd's Rep. Med. 405*).

The legal analysis of this issue can sometimes turn on counter-factual or 'what if' considerations: in *NRAM Ltd v Steel [2018] UKSC 13; [2018] 1 W.L.R. 1190* a borrower's solicitor mistakenly provided a lender with inaccurate information which caused it to lose its security over two properties; it was held reasonable for the solicitor not to foresee that the lender would not check the information.

It seems that the FCA has sought to deploy the broad concept of foreseeable harm in order to give itself a wide discretion in causing firms to become more customer-focussed. However, the very breadth of the concept may enable firms to raise challenges as to exactly what might or might not be or have been foreseeable.

Read the rest of the series:

Consumer duty part 1 - 'The drill-down' into the 'cross-cutting' rules →

Consumer duty part 3 - 'The drill-down' into the 'cross-cutting' rules →

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