



Financial Services Authority

Treating customers fairly – building on progress

July 2005

We would welcome any comments on issues raised in this document. You can send us comments by e-mail: tcf@fsa.gov.uk.

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1 Overview

The importance of Treating Customers Fairly (TCF)

- 1.1 An efficient and effective financial services market requires:
 - Firms to treat their customers fairly, including by disclosure of clear, useful information about products and services which enables consumers to see what they are being offered; and to be well managed and soundly capitalised.
 - Consumers with the capability to understand the information and advice they are given. To support this we are working with a range of partners to deliver the National Strategy for Financial Capability.
- 1.2 Together, these elements – enhanced consumer capability and financially sound firms that treat their customers fairly – can make a real difference, through:
 - firms designing products for their target market;
 - firms providing clear information which equips confident consumers to make good decisions and to be able to question the advice and information they are given; and
 - effective complaint handling when things go wrong, so firms clearly address the issues being raised by consumers and put things right where necessary.

What do we expect of firms?

- 1.3 All firms have to comply with the existing rule set out in the Principles for Businesses, that *a firm must pay due regard to the interests of its customers and treat them fairly*. The high level requirement of that Principle is already in part expanded through detailed Rules and Guidance in the Handbook, particularly in the conduct of business sourcebooks for investments, general insurance and mortgages.

- 1.4 Because of the wide range of activities carried on by authorised firms, it is not possible to define TCF in a way that applies in all circumstances. Making more detailed rules would also restrict the freedom of firms to form their own views about how to treat their customers fairly, without necessarily improving consumer protection. While we recognise that it will be a challenge for us and firms, we are aiming to maintain a principle-based approach which will give firms greater flexibility over how they can best meet the requirements of TCF.
- 1.5 Firms therefore need to make their own assessment of what is appropriate for them, taking account of the nature of their business.
- 1.6 We expect firms actively to consider whether they have embedded TCF into all aspects of their operations, including in all the different interactions they have with consumers.
- 1.7 We want firms to challenge ways of doing business that may be very familiar. Most firms in the financial services industry aim to treat their customers fairly. They recognise the commercial importance of satisfied customers. But, even in these firms, there are often practices which have grown up over time, or that have not kept pace with other changes in the financial services market, which need to be reviewed against the principle of TCF.
- 1.8 We expect consumers to be able to rely on the same high standards regardless of the size of the financial firm they are dealing with – the principle of TCF applies equally to all firms. But delivering TCF may, in practical terms, be very different for the senior management of a small firm to what it means for the senior management of a large firm. The senior management of a small firm is much more closely connected with the customer facing parts of the business, and so assessing the firm's performance and delivering change may be simpler to achieve. It may also be the case that the senior management of small firms will need relatively little by way of formal management information (MI) to be satisfied that the business is delivering against its TCF objectives. The implications of TCF for smaller firms are discussed further in Annex 1 of this paper.
- 1.9 We have seen encouraging signs of firms making progress, and this paper gives an insight into some of the things that they have done and are doing. But some firms are still asking what, in practical terms, we are expecting them to do.
- 1.10 The report we published in July 2004 – *Treating customers fairly – progress and next steps* – set out the product life-cycle as a simple framework that firms could use to structure their thinking about different aspects of TCF. This framework will not be directly applicable to all firms but, to the extent the stages are relevant, this means considering TCF in respect of a firm's activities in:
- product design;
 - marketing, including the production of promotional material and disclosures;

- the sales process, including advice where that is given and the information provided to consumers as part of the sales process;
- the way that staff are remunerated;
- information and customer support after the point of sale;
- complaint handling; and
- management information.

1.11 Not all firms are engaged in product manufacture. And not all firms distribute products directly to consumers, but they may still have obligations to retail customers. Some firms provide services, including advising on products manufactured by others. In considering what TCF means for them, those firms will need to look at their approach to providing a service rather than looking at the product life-cycle. Firms also need to take account of the impact of their actions on the ability of other firms they deal with (producers, distributors and outsourced suppliers) to treat their customers fairly.

1.12 We have been working closely with industry representatives, individual firms, consumer bodies and many others to provide material to help firms focus on the issues they should be thinking about. We published a collection of such material on our website in March 2005. This, together with additional material we have developed more recently, is summarised in Section 3 of this paper. This material is not intended to be prescriptive. Nor can it hope to cover all the situations faced by firms in practice. But the feedback we have had from firms shows that it is a helpful starting point for considering what TCF means.

Implementing a TCF strategy

1.13 We will continue to look to senior management to explain how they are going about considering what TCF means for their firms. They need to do so in a way that is proportionate for their business.

1.14 Firms need to take into account factors such as the firm's activities, the products and services it provides, its customer base and its strategy.

1.15 Having considered the implications of TCF for their business, firms will be able to complete a 'gap analysis' to identify any shortfalls. Where necessary, firms will need to embark on a programme to address any shortcomings. Such firms need to set clear priorities and targets and determine how progress will be tracked to ensure that change is being successfully delivered and makes a real difference to consumers. Section 4 sets out a framework to help firms develop their TCF strategies. Some firms have chosen to seek assistance from consultants, but it is certainly not a requirement to do so.

- 1.16 We do not expect all problems to be fixed on day one. But where change is needed, firms should have a clear and proportionate plan to address problems and be confident that they can contain the risks where gaps remain and management need to ensure that the firm is successfully implementing the plan.
- 1.17 Delivering TCF will often have implications which cut across the business – for example, with respect to internal governance and accountabilities, systems and controls, training and HR processes. It may also affect how firms interact with their staff: buy-in and engagement from staff on the ground is key if the senior management’s high-level objectives for TCF are to be delivered. A real benefit of achieving that engagement is that front-line staff should be an invaluable source of feedback, on whether the firm is meeting its TCF aspirations, on the practical issues which customers are facing and on ways that such issues could be resolved.
- 1.18 We will provide feedback on the lessons that have emerged from firms undertaking such work, broken down by industry sector, business activity and firm size.
- 1.19 If our supervision work in future identifies failings in TCF in a firm, we will consider the most suitable course of action. In many cases, we will agree with the firm how it intends to address the failings and, where necessary, give customers redress when the failings have resulted in a loss to them.
- 1.20 Failure to treat customers fairly may lead to enforcement action resulting in a public censure or a penalty. In reaching a decision on whether we should follow an enforcement route, we will take into account whether the firm has considered the implications for TCF, and whether senior management has played the role we expect of it in this context. Where a firm has not responded to indications that there are problems, has failed to identify shortcomings where they exist and to develop a strategy to remedy them, and has committed a serious breach of the principle, we will be more likely to take enforcement action. But we do not expect to take enforcement action when firms have made a genuine attempt to deliver on what they consider TCF means for them and there has not been significant risk to consumers.

Progress over the last year

- 1.21 In our July 2004 paper, we recognised a range of ways that standards had improved across the financial services sector in recent years, in response to both regulatory change and industry initiatives. But we also noted that we continued to find examples of poor treatment of customers in retail financial services and that there was more for firms to do. We have since identified some examples of good and bad practices and provided feedback to firms. Sections 3 to 5 of this paper provide more such information.

- 1.22 We have seen increased awareness of TCF, particularly among the largest firms, in many medium-sized firms and in the sectors where the trade association has been actively engaged in a dialogue with their members on TCF. We have not so far undertaken a detailed study of the work being done by smaller firms who do not have a supervisory relationship manager.
- 1.23 We have found that the firms we have talked to have made further progress over the past year, with evidence of many individual firms reviewing the implications of TCF for their business.
- 1.24 Many firms have reviewed whether the way they are organised ensures that their customers are treated fairly, and have started to address some of the concerns that they identified. Some firms have told us that they had thought they met an appropriate standard, but, once they started to look systematically, they uncovered a number of areas where they needed to improve. Others have told us that they had started by focusing on issues around the point of sale, which they had regarded as the key problem area, only to find that they needed to look at a wider range of issues.
- 1.25 We have seen evidence of firms starting to make practical changes to the way they go about their business as they implement TCF strategies. Encouraging examples we have seen include firms building TCF into their product design process by stress-testing new products from the customer's point of view; putting additional effort into communicating the risks and benefits of new products clearly; and using after-sale surveys to test whether consumers have really understood what they have bought.
- 1.26 However, a minority of the firms we have looked at have not yet gone much further than considering the governance of their TCF work. And even where we have seen increased awareness, this has not always resulted in changes at the sharp end of the business – such as at the adviser's desk, at the branch till or in the approach of staff handling complaints.
- 1.27 In reviewing the steps firms have taken to build TCF into the way they carry out their business, we have identified a number of lessons:
- Senior management has a key role to play in providing leadership, whether leading their TCF programmes – a CEO of a large retail financial group chairs the senior management group tasked with delivering TCF – or supporting and endorsing the work done by those accountable to them for delivering TCF.
 - In deciding their approach to TCF firms need to take account of their strategy, the sector or sectors they operate in, the products and services they offer and their client base. There is no single template.

- TCF is as much about staff behaviour and the culture and approach of a firm, as about systems and controls. So engaging, training and motivating staff is essential.
- MI is an important challenge. Firms recognise that the outcomes from TCF programmes need to be clearly identified. And the individuals within the management structure need to have appropriate information to enable them to track progress and monitor delivery. Revising MI systems takes time and firms are finding that they have considerable analytical work to undertake to determine what MI they need. In the short term, some firms are considering what additional use they can make of existing MI.

1.28 Trade bodies have engaged actively in TCF work in the past year, including by considering specific TCF issues and providing material for their members, and helping them share ideas. Examples have included running seminars on TCF topics and producing TCF guides and manuals as described in Section 5. Such work by trade bodies is particularly valued by smaller firms.

Our future plans

- 1.29 TCF is part of our approach to principle-based regulation. Separately we will shortly be setting out our plans for simplifying the Handbook. Our aim is to give firms, and their senior management, greater responsibility for deciding how to go about delivering the requirements of our rule book including the high level principles such as TCF. This approach should help us to remove a significant number of detailed requirements. As part of this work we will set out in more detail our approach to principle-based regulation and the implications this will have for firms and our own work.
- 1.30 Having built up our practical understanding of TCF and its implications for firms across broad areas of the industry, we are now building TCF into supervisory work. We have started to assess how firms have considered TCF in the context of their business and the conclusions they have reached.
- 1.31 Starting later this year, TCF will become a core part of our ARROW risk-assessment process¹. Supervisors will, during risk assessments, identify what firms have done to assess what TCF means for their business and how they are addressing any shortfalls that have emerged. We recognise the need to develop further training for our staff about what they should expect of firms and to support the adoption of a consistent approach across the range of firms. We know industry shares our view of the importance of getting that right.

¹ More details about our approach to supervision is available on our website: www.fsa.gov/Pages/Doing/Regulated/RMRA/index.shtml

- 1.32 When deciding on our priorities for future work, including deciding topics for further supervisory cluster work, and in terms of supervision of individual firms, we will focus on areas of highest risk.
- 1.33 Our TCF Consultative Group (which comprises representatives from a range of trade associations, the Financial Services Practitioner and Consumer Panels, our Smaller Businesses Practitioner Panel, the Financial Ombudsman Service, a consumer body and a personal finance journalist) has been very helpful in reviewing the TCF material we have developed and in discussing particular issues such as TCF and smaller firms. We will continue to have an active dialogue on TCF with the Consultative Group, firms and others through working groups and conferences. We will also actively help smaller firms in addressing TCF.
- 1.34 We will be doing further work on measuring the impact of the TCF programme on our end-objective of delivering fairer treatment of customers.
- 1.35 Section 6 details our plans for taking our TCF work forward.

CONSUMERS

This paper is aimed at regulated firms but should also be of interest to consumer groups.

2 Introduction

Purpose of paper

- 2.1 This paper is intended to help firms and others assess the practical implications of the principle that firms must pay due regard to the interests of their customers and treat them fairly.
- 2.2 This material draws on the supervisory work carried out over the last year across a number of parts of the product life-cycle, in large, medium and small firms and across different sectors of the industry. There is more detailed information on our website (www.fsa.gov.uk/tcf), which includes a series of case studies looking at the implications of TCF in different contexts.
- 2.3 Firms are responsible for treating their customers fairly. But consumers also need to play their part. We have been working with representatives from our Consumer and Practitioner Panels to consider the respective rights and responsibilities of firms and consumers. We are working on a document considering these in the context of the sale of an advised investment product, which we will discuss with our TCF Consultative Group shortly.

Structure of paper

- 2.4 This paper:
 - summarises the findings from our supervisory (or ‘cluster’) work and the material we have produced to assist firms and reports on further work we have carried out more recently (**Section 3**);
 - sets out how firms can consider if they have embedded TCF in all aspects of their operations (**Section 4**);
 - reviews progress made by different groups of firms in considering what TCF means for their businesses (**Section 5**); and
 - identifies other key issues relevant to TCF and sets out our plans for further work on TCF in the coming year (**Section 6**).

2.5 The annexes to this report cover:

1. TCF and smaller firms;
2. the role and membership of the TCF Consultative Group;
3. summary of TCF website material;
4. the findings of our consumer research; and
5. TCF and other fairness requirements.

TCF in context

- 2.6 Effective competition is key to delivering products and services that meet the needs of customers. Where market failure exists, however, joint action by firms in a sector, often through their trade association, can deliver the necessary change. In other cases, where there is no market solution, regulatory intervention is needed to protect consumers when regulation has the prospect of doing more good than harm.
- 2.7 In our July 2004 paper we described the scope of the TCF project. In that, we noted the need to develop a better and common understanding of TCF and invited firms and others to engage with us on what fair treatment of customers means in practice. In that report, we set out some of the things that TCF does not mean.

TCF does not mean

- Being ‘nice’ to customers or creating satisfied customers.
- All firms are required to offer the same, or highest, levels of service.
- Inhibiting innovation in new products.
- A firm must design or market different products for each individual customer.
- We will be an arbiter of what products consumers should want or be sold
- Customers are no longer expected to take decisions or to take responsibility for them.

All these remain true.

- 2.8 But our discussions with interested parties over the past year have suggested that it would be helpful to add to this list.

- **TCF is not intended to create new rules or obligations on firms. Nor is it about creating checklists for firms to comply with.** The material in this document, and the more detailed material on the website, suggest factors that firms might want to consider in meeting their obligation to treat their customers fairly.

- **TCF is not a process intended to lead to a continuous ratcheting up of standards across all firms, nor one intended to make all firms match best practice.** Firms need to be able to explain how they have assured themselves that the way their business is organised treats their customers fairly. This will be part of our regular dialogue with firms. Where there are shortfalls, firms will be expected to show how they are going to address them. But supervisors will not be using TCF to seek to continually raise standards where the firm has demonstrated that it is already treating its customers fairly.
- **TCF does not indicate that we intend to become an economic regulator.** It is not our role to determine firms' pricing policies.
- **TCF is not about making firms adopt the same or bureaucratic processes.** TCF is not about setting up costly systems and extensive governance processes. This paper will give firms a clearer indication of what TCF involves. Ultimately, the senior management of the firm is responsible for ensuring that a firm complies with its regulatory obligations and so it is for the firm's management to decide how they can be satisfied that they do so.
- **TCF is not about collecting large amounts of MI.** Our concern is to make sure that firms deliver on their regulatory obligations, including TCF. As a matter of senior management responsibility, management need to be able to know how their business is performing and MI will be an important part of that assessment. We do not want firms to collect MI that serves them no useful purpose.

- 2.9 So what TCF means in practice and how to achieve it is a decision for individual firms and their senior management, taking into account factors such as the structure of the firm, its operations, strategy and customer base.
- 2.10 Making detailed rules to apply to all industry sectors and all types of firm would restrict the freedom of firms to decide what TCF means for their business. Nonetheless, we do recognise the need to help develop a common understanding of what TCF means in practice.
- 2.11 We have used the concept of the the product life-cycle to identify some of the key activities in firms which can threaten the fair treatment of customers. This covers:
- product design;
 - marketing practices;
 - the sales process including advice where that is given and the information provided to consumers as part of the sales process;
 - information and customer support after the point of sale; and
 - complaint handling.

- 2.12 Our supervisory work has examined some other specific issues which have the potential to have an impact on whether customers are treated fairly:
- remuneration of sales staff, senior management and other staff;
 - managing the interfaces between producer and distributor firms;
 - taking treating customers fairly into account when firms are considering strategic change; and
 - the role of management information in enabling firms to be sure they are treating their customers fairly.
- 2.13 We have published the results of this work on our website, with further results added in July 2005. We do not repeat all this information in this document, but we do highlight some of the key issues and lessons which we think senior management should consider.
- 2.14 After discussion with our TCF Consultative Group, we produced a case study which examined some of the issues a firm might want to consider in meeting its obligation to treat customers fairly in the context of designing and introducing a new product. The feedback from the Consultative Group, and since then from a number of firms, has been that this was helpful. We have since developed several other case studies (see Annex 3) which have been discussed with our Consultative Group. These case studies are available on our website.
- 2.15 During the past year, we have begun regulating general insurance and mortgage business – we also highlight some issues firms in those sectors might review as they consider what TCF means for them. We plan to discuss these further with representatives of firms in those sectors (see Section 3).
- 2.16 None of this material imposes new requirements on firms. Nor will all of this material be relevant to all firms – the product life-cycle approach does not fit exactly with the activities of some firms. This material is, however, available to help firms, trade bodies and others when considering the requirement of treating customers fairly in different circumstances. It will also be available to our supervisors, but it will not be treated by them as a ‘checklist’ against which to test firms.

3 Our findings and the challenges to be addressed

- 3.1 Between October 2004 and March 2005 we carried out supervisory ‘cluster’ work looking at the ways a sample of over 80 firms were taking account of TCF in their businesses. We focused on: product design, the interfaces between producers and distributors, staff remuneration, management information, complaints management and managing strategic change.
- 3.2 This section summarises that work. It also highlights other challenges facing firms, including issues that mortgage and general insurance firms may wish to consider.

Findings of our cluster work

Product design

- 3.3 Consumers can obtain significant potential benefits from access to a wide range of well-designed products, augmented by continuing product innovation.
- 3.4 Complex or high-risk products can, as part of a portfolio, play a useful role for particular consumers, provided they are targeted at the right groups of consumers and as long as there are effective controls covering their marketing and distribution.
- 3.5 But if firms do not properly structure, test and review the products they design and consider the impact on the consumers for whom they are likely to be suitable, they risk creating products that will fail to meet consumer needs. This may result in consumer detriment, particularly if the products are poorly marketed and advised.

Some issues for firms to consider in Product Design

- How might future external events have an impact on the performance of a product? How might the product perform in very different environmental conditions? What role should stress-testing play in examining these risks?
- Which target groups of consumers would the product be suitable for – and which not?
- How can the features and risks associated with the product be communicated to target consumers in ways they are likely to understand?
- Will the product material enable those marketing and selling the product (including intermediaries) to understand, and so explain, the product's features and its risks?
- Has the firm considered what infrastructure it will need to have in place to support the product after launching it?

3.6 We reviewed practice in several firms involved in product design and found:

Many firms make use of consumer research in designing new products, but often on who would want to buy a product and how to market it better, rather than who it is suitable for.

There are examples of some firms using consumer research and other tools to make sure they meet TCF obligations such as:

- testing literature on customers for understanding.
- testing whether customers understand a product's risks.
- using focus groups to evaluate new products.

But not all firms have procedures to assess the needs and level of understanding of the customers that their products are aimed at. Some firms:

- use consumer testing only to understand how to market products better, and not to assess who the product is suitable for.
- rely on their sales force or distributors to research and test products or literature.

Firms use a variety of ways to control new product approval. But, generally, insufficient effort is made during the development process to assess and manage the risks that products may present to customers. In some firms there is a lack of evidence of clear senior management control and accountability.

Firms have applied controls in several different ways, such as:

- auditing the product design process for TCF, and presenting the findings to the Board.
- including formal TCF assessments in the approval process for new products, such as how:
 - the inherent risks in the product are communicated to customers.
 - customer needs have been included in the design process.
 - the inherent risks in the product have been mitigated.

But some aspects of current practice in some firms cause us concern, including:

- a failure to assess TCF issues, specifically potential risks to consumers as opposed to the firm.
- technical staff develop products and hand over to a marketing team to devise how to sell them, with no evidence of effective liaison between the two teams or of consideration of TCF issues.

| Some manufacturing firms do not see TCF as being relevant to them as they have no direct contact with end-consumers. Others have reviewed their role to reduce the risk of inappropriate selling. | |
|--|---|
| <p>Some product developers have reviewed their role to contribute to fairness at the point of sale. Examples include:</p> <ul style="list-style-type: none"> • providing detailed training and literature to intermediaries on general technical issues as well as product-specific issues. • putting all product literature through a rigorous review process before being satisfied that it properly explains risk. • testing new products on user groups, including whether consumers understand them. | <p>But others are taking a less active role in protecting customers from inappropriate risk. Examples include:</p> <ul style="list-style-type: none"> • providing limited information to distributors, on the assumption that they already have adequate understanding. • relying excessively on distributors having specialist knowledge. • inadequate training or resourcing of service staff to handle technical queries from distributors after a product is launched. |

Managing interfaces between product providers and distributors

- 3.7 Unfair outcomes can arise from failures at any stage of the product design, sales, service or customer management processes. So producers and distributors of financial services products both have a role to play in ensuring that customers are treated fairly. It is important for firms to be clear about who is responsible for each aspect of the service and who may be liable if the product fails to perform as expected by the investor.
- 3.8 Broadly speaking, the ‘producer’ of the financial product is responsible for operating or managing the product according to the key features and other marketing literature that it prepares and distributes and that these provide a fair and balanced picture of the terms, nature and risks of the product. The seller or distributor of the product by contrast is responsible for its own marketing effort and, when giving advice, for ensuring that the product is suitable for the purchaser. Our work has looked at how, in practice, firms have managed their respective responsibilities and what further steps they take to protect customers.
- 3.9 We plan to do further work to look at the responsibilities of producers and distributors to test the balance in this relationship. A firm, whether acting as a producer, a distributor or in other roles, needs to consider its responsibility for TCF and the implications this has on its interactions with other firms.

Possible TCF issues for managing interfaces

- Has the firm considered its obligations to treat customers fairly and the implications this has for its interactions with other firms? For example, when a firm is providing a product which will be distributed by others, has it considered whether the material it provides for distributors and their advisers clearly describes the features and risks associated with the product?
- When selecting and maintaining partners and reviewing the commercial considerations involved, has the firm also taken into account the implications for fair treatment of customers?
- How should senior management monitor and review the performance of partner firms during the lifetime of their relationship as part of their general oversight responsibilities?

Senior management may find it useful to consider how delivering the principle of TCF can be affected by their business relationships and the systems and control they put in place over them. It may be helpful to consider TCF when:

- defining the expectations and arrangements for a relationship;
- managing relationships with distributors; and
- managing relationships with product providers.

A number of these issues are equally relevant to managing relationships with outsourced service providers.

3.10 Our cluster work on managing interfaces found:

For both manufacturers and distributors, there is limited evidence that TCF is a consideration in setting up and managing relationships.

There are examples of management taking steps to ensure customers are treated fairly when a number of firms are involved in delivery. These include:

- a distributor assessing partners for similar values, quality of service and appropriate expertise before issues of cost or profit.
- a product provider terminating relationships that might damage the provider's brand, despite potentially losing large business volumes.

But others are taking a less active role in protecting customers from inappropriate risk. Examples include:

- providing limited information to distributors, on the assumption that they already have adequate understanding.
- inadequate training or resourcing of service staff to handle technical queries from distributors after a product is launched.

Staff remuneration

- 3.11 Firms view remuneration as an important part of their strategy. This is often driven by commercial considerations such as the need to attract and retain staff of appropriate quality, and motivate them to achieve key business objectives such as sales targets and profit growth. Clearly, remuneration structures are also a matter of agreement between firms and their staff
- 3.12 Remuneration practices differ across sectors of the industry and even roles within firms, reflecting the objectives and responsibilities of those roles.
- 3.13 Remuneration can be an important factor in achieving business objectives, but a failure to manage and control the risks inherent in particular remuneration structures can threaten a firm's ability to treat its customers fairly. A heavily commission-driven structure for sales staff, for example, can create risks which need to be effectively managed.

3.14 But while the remuneration of customer-facing sales staff may be important for some firms, it is not the whole story. Other staff – senior management and those working in areas such as product design, compliance and risk – can also affect a firm’s ability to treat their customers fairly. And pay is of course only one form of incentive: promotion, recognition and other non-monetary rewards can influence staff behaviour.

Possible TCF issues concerning remuneration

- How are sales staff remunerated? How does the firm manage risks arising from setting up incentives to encourage staff to meet particular sales targets?
- How to set targets and rewards for non-sales staff (including senior management, marketing, customer service, complaints handlers, compliance, and middle management) who can have an impact on the fair treatment of customers.
- How can outsourced providers be incentivised to help deliver the firm’s TCF objectives?
- How wider reward and people management factors (such as objective-setting, promotion strategy, disciplinary procedures) support TCF.
- Does the firm have the right balance between rewards for compliance and other non-sales staff and sales and marketing etc?

3.15 We found:

More could be done to create controls and reflect TCF in the pay and reward of senior managers and non-sales staff.

More examples are emerging of TCF-supporting measures for senior management and non-sales staff, including:

- a group bonus scheme, linked to customer satisfaction for all staff and directors.
- monitoring the quality of calls and taking this into account in the remuneration of customer service staff.

But, overall, there is little evidence of TCF being considered for non-sales staff. We saw practices such as:

- customer service and complaints-handling staff rewarded on time spent on each customer or cases handled per day. This could encourage staff to concentrate on the volume of cases handled at the expense of quality and TCF.
- at manager level and above, bonuses are often paid on achieving growth and profit targets alone, with little direct link to customer issues.

Despite more evidence of staff being rewarded for meeting quality targets, there are many areas where remuneration of sales people may create risks to TCF if not appropriately managed.

Almost all the firms visited had taken some measures to mitigate sales bias. Examples we have seen include:

- a single commission rate for all products in the same product family, to eliminate bias.
- failure to meet quality standards resulting in loss of commission.

But other ways of remunerating sales people may not support TCF, such as:

- sales staff’s remuneration being totally commission-based.
- appraisal processes being based on a balanced scorecard approach, but actual bonus or salary increments still being based on sales.

- 3.16 Most recently, we have been encouraged to see some firms recognising the importance of reviewing remuneration strategies as part of their TCF programmes. One firm stated that although income-generation continues to be a strong driver, it recognised the commercial value as well as a reputational value in incentivising good behaviour and quality work. Another firm was starting to introduce rewards reflecting net sales, taking into account retention rates as well as sales volumes – of course this does not necessarily remove all risks where products are long term. In another case, a firm has started to deduct redress payments awarded from a team’s discretionary bonus.

Management information

- 3.17 Senior management needs to ensure that it has access to appropriate MI. Just as TCF is not a new requirement, so TCF should not generally require the creation of substantial amounts of new information.
- 3.18 Many firms have found, however, in the context of considering whether TCF is embedded in their businesses, that there is a need to review some current MI. They have found that review is necessary both in terms of coverage and in terms of delivering the right information to those responsible for different aspects of TCF. In some cases, although relevant information is already collected, it may not be fully used in terms of monitoring TCF.
- 3.19 The MI requirements will depend upon the scale and business of the firm concerned. They should also be proportionate and cost effective. In a small firm with few lines of business – where senior management are likely to be much closer to the day-to-day interactions with customers – the MI will be much simpler than those in a much larger firm or a firm whose operations are more complex.
- 3.20 The effectiveness of MI systems will be one of the issues supervisors will expect to discuss with firms in the context of supervisory work on TCF. We plan to undertake more cluster work on MI in the coming year.

Possible TCF issues concerning MI

- Have adequate performance measures been identified to track delivery of TCF and are identified changes effective in closing the gaps?
- Does current MI cover areas that are relevant to TCF?
- Is information already available within the business sufficient, can it be used more effectively and, if not, what other information is available and how can this be obtained?
- Is the information produced ‘fit for purpose’?
- Is MI filtered and distributed to appropriate audiences within the firm including those responsible for different aspects of TCF?
- Is MI reviewed and are conclusions drawn that may be relevant to other parts of the business?

3.21 We found:

| Several firms had difficulty identifying and analysing the MI required to monitor delivery and improvement. | |
|---|---|
| <p>Firms have adopted different approaches to identify, capture and act upon TCF information. Approaches being taken include:</p> <ul style="list-style-type: none">• one firm prepares a monthly MI pack to include reports from compliance, complaints trends, persistency rates, customer treatment standards, staff survey responses, satisfaction and loyalty among advisers, press coverage, and customer comments.• TCF being included in quarterly reports to senior management from project directors engaged on major change programmes. | <p>But progress is slow and there are serious gaps in many firms' MI:</p> <ul style="list-style-type: none">• too much focus on TCF issues only at the point-of-sale and insufficient data collected to assess TCF elsewhere.• although MI is being collected, little effort is made to identify or establish how it can be used to show if TCF is being delivered.• more to be done to make sure that MI concerning TCF is being delivered to the right parts of the management structure. |

3.22 Since we completed this cluster work, we have continued to explore with some larger firms how they are approaching MI. Most firms we have talked to say that they are currently undertaking a review of MI to help identify key indicators to help them measure success. Areas they are reviewing include complaints, persistency and sales volume data, and using customer satisfaction surveys and mystery shopping.

3.23 In some instances, firms have existing MI that helps them to measure TCF performance, but they are looking to see what additional MI can be used. Others are identifying gaps in their current data sources and considering how these can be filled. However, some firms appear unwilling to invest in developing new MI systems to support TCF delivery until they have carried out further work and are clearer about what TCF means for them and made progress in setting their objectives.

Complaints management

3.24 Fair and efficient complaint-handling plays a key role in consumer protection, as mistakes happen in even the best run firms. Effective complaint handling helps to address such issues. Complaints received should also be a valuable indicator of the effectiveness of a firm's systems, pointing to problems in a firm's operations which need to be addressed. And the need for regulatory intervention is reduced when we can rely on firms' complaint-handling mechanisms to deal properly with consumers who have not been treated fairly.

- 3.25 Good complaint-handling involves more than just responding to the specifics of the issue raised by the customer. It is also about the firm making the effort to understand the customer's issue, and responding in a clear and straight-forward way. The number of cases referred to the Financial Ombudsman Service and subsequently upheld in favour of the customer will often be key indicators that management (and supervisors) can refer to when assessing the effectiveness of complaint-handling arrangements.
- 3.26 Good complaint-handling does not mean always finding in favour of the customer. Nor does it involve being biased in their favour. It is about treating customers' complaints fairly and efficiently. However if a firm chooses – for its own commercial reasons – to start from a presumption that the 'customer is always right', that is its prerogative.

Possible TCF issues arising from complaints management

- Are staff encouraged to consider complaints positively? In what circumstances would a rise in the number of complaints be a positive as opposed to a negative indicator?
- Are there appropriate incentives for staff to treat complaints fairly?
- Are staff encouraged to recognise expressions of dissatisfaction from customers as complaints and to record them appropriately in the firms' systems?
- Has the firm allocated sufficient resources to deal with complaints efficiently? Does the firm track complaints trends in a timely manner so it can respond quickly if, for example, volumes suddenly increase?
- Does the firm put up any unnecessary barriers, making it difficult to complain?
- How can the firm ensure that complaints are fully and fairly investigated? If the review of complaints involves potential conflicts of interest, is this properly managed?
- When communicating with customers, is the firm's material clear and concise, avoiding unnecessary 'legalese'?
- How does the firm learn lessons from complaints data?
- Does senior management exercise control over complaints-handling?
- How does the firm check that it remedies the root cause of complaints, in order to prevent similar problems recurring?
- Does this analysis extend to complaints that have been referred to the Financial Ombudsman Service?

- 3.27 In recent years many firms have prioritised complaints work and allocated additional resources. In several firms we found that senior management are more aware of the importance of complaints. However, in many firms there is more to be done. Our findings included the following:

| Not all senior management teams set the right tone for complaints handling. | |
|--|---|
| <p>Some senior management teams have started to build a culture that values complaints and recognises the importance of managing them well. Actions include:</p> <ul style="list-style-type: none"> • the Executive Team holding a conference hall session with staff to explain the importance of complaints. • responsibility for complaints given to a senior director, and the head of complaints made a member of the Strategy Committee. | <p>But not all senior management view complaints positively. Examples include:</p> <ul style="list-style-type: none"> • not accepting the value of complaints or seeking to learn from them. • having the attitude that only complaints from valuable customers matter. |

| Some firms are building strong links across their business to improve the capture of, and response to, complaints, but too many firms put barriers in the way of customers. | |
|---|--|
| <p>Some firms are building stronger links across the business. This includes:</p> <ul style="list-style-type: none"> • formal agreements between business units that new literature or marketing material is reviewed by Customer Relations to help identify and eliminate potential sources of complaints. • management reassuring staff that complaint volumes may increase as they make complaining easier by 'phone, email, face-to-face and fax, linked to training on how to identify and record a complaint. • creating an environment where complaints are seen as valuable feedback to help improve business performance. | <p>But some firms remain uncoordinated in their approach, with behaviours such as:</p> <ul style="list-style-type: none"> • viewing complaints as just an issue for Compliance or the Complaints Department. • failing to set out clearly for their staff the complaints processes and procedures. |

| The quality of work to investigate and assess complaints varies widely from firm to firm. | |
|---|---|
| <p>There are examples of firms actively improving how they assess complaints:</p> <ul style="list-style-type: none"> • decision-making policy set by a committee comprising strategy, compliance, legal, and senior management. • senior management reviewing a sample of decision letters each month to check appropriateness and consistency. | <p>But some firms fail to assess complaints fairly. This includes:</p> <ul style="list-style-type: none"> • aggressive and negative internal culture predisposed to view complaints as mainly unjustified. • applying a rigid or tick-box decision-making approach, with too narrow an interpretation of the issue as expressed by the customer. • failing to seek to understand the concern of the complainant. |

| Standards of communication are mixed. Some firms use too much jargon or ‘legalese’ and fail to keep customers informed of progress of the complaint. Others have recognised that clear and constructive communication is a key part of complaints-handling. | |
|--|--|
| <p>Some firms recognise that clear and constructive communication is an important aspect of handling complaints fairly, with approaches including:</p> <ul style="list-style-type: none"> • calling the complainant after receiving a complaint to check the nature of the complaint and gather more details and background about it. • tracking the amount of communication following the issue of a final decision letter to identify errors in the explanation of the decision. | <p>But standards of communication are mixed, including:</p> <ul style="list-style-type: none"> • poor drafting and over-use of legalese and corporate jargon. • failure to keep customers informed of the progress of complaints. • not responding to customers’ queries. |

| There are good examples of firms acting to improve management information on complaints, but in many firms MI is inadequate and little effort is made to address root causes. | |
|--|--|
| <p>Action taken includes:</p> <ul style="list-style-type: none"> • analysing the number of complaints received and completion times, compared to predicted levels, with commentary explaining variance, peaks and troughs. • reviewing the root cause of each complaint. • requiring manager-level approval for a complaint to be closed. | <p>But many firms have inadequate MI and are not addressing the root causes of complaints. Examples include:</p> <ul style="list-style-type: none"> • one firm had low complaints volumes but very high call centre ‘query’ volumes. There was no MI to tell what the queries were about, whether they were recurrent or what was causing them. • failure to extrapolate issues from one process or product to see if they affect other processes or products. |

Taking TCF into account when managing strategic change

- 3.28 Customers are best served by a competitive market. Management need to be able to pursue profitable new business opportunities, and to seek ways to improve operational efficiency and business performance.
- 3.29 But when considering possible strategic change, firms should start considering the implications for treating customers fairly at an early stage.
- 3.30 To examine how firms went about this, we reviewed the ways in which a number of firms were considering change in the context of depolarisation.

Possible TCF issues for strategic change

How can TCF be taken into account when:

- entering new markets – either in terms of customers served, or products/services offered;
- undertaking mergers or acquisitions and disposals involving some or all parts of the business;
- cost cutting or implementing operational improvement activities such as outsourcing, centralisation or staff cutbacks;
- implementing major new systems affecting customers or products; and
- changing business status, such as taking advantage of depolarisation?

Each of these may be a valid strategy, or component of a strategy, for a firm. But when under pressure to deliver a new approach, there may be a risk to TCF considerations if it is not considered part of the decision-making process and built into the plans to manage change.

We would expect firms to protect consumers from potential detriment during major change by:

- considering TCF at the business case development and assessment phase;
- considering TCF during the planning and implementation process; and
- monitoring the impact of the change.

3.31 When looking at depolarisation, we found that few firms explicitly considered the implications for TCF in the decision-making or planning phases. Our findings included:

During depolarisation changes, many firms did not do enough properly to understand customer requirements.

There were some examples of firms using customer research to inform their decisions:

- one firm undertook research which showed that customers valued and had a clear preference for independent advice. As a result, the firm moved from a tied sales force to wholly independent status.
- a distributor assessed partners for similar values, quality of service and appropriate expertise before issues of cost or profit.

In general, however, little effort was made to drive decisions from a deep understanding of customer needs:

- one firm decided to gap-fill its product range with products selected on the basis of what its advisors thought they could sell. There was no consideration of fairness to customers.

Firms did not always pay sufficient attention to their ability to support customers adequately following a change of status as a result of depolarisation.

Some firms did consider the operational impact of change on their customers and the ability of the firm to support the change:

- one firm decided to reduce its product range and focus on a smaller range of simple products that are clearer for customers and staff to understand.

But some firms did not seem to consider the full impact on customers of a change in status:

- few IFAs took the opportunity to assess if they could really provide customers with effective whole-of-market service after point of sale – e.g. in terms of training or resourcing to handle technical or servicing queries.

| Firms had not always thought through how to treat customers fairly following a change in status. | |
|---|--|
| <p>A small number of firms have clearly considered customer issues in deciding how to implement a change of status:</p> <ul style="list-style-type: none"> • a firm that has both whole-of-market and multi-tie operations keeps these propositions in separate subsidiaries to reduce the risk of customer confusion. | <p>But other firms do not seem to have taken account of TCF or made clear to customers how the business works following a change in status:</p> <ul style="list-style-type: none"> • a firm planning to set up a multi-tie operation has been considering how to use branding to 'convey impartiality' despite the risk of misleading customers into believing this means fully independent advice. |

Other sectors: mortgages and general insurance

- 3.32 We took over responsibility for regulating mortgage sales in October 2004, and responsibility for regulating the sale of general insurance products in January 2005.
- 3.33 With those regimes in place, firms in those sectors have started to ask for help in understanding what TCF means for them. Many of the issues discussed elsewhere in this paper apply in similar ways to providers and distributors of mortgage and general insurance products. For example, good complaints-handling arrangements are just as important in those sectors as they are elsewhere.
- 3.34 As elsewhere, we make no presumption that individual firms in these sectors have shortcomings that they need to address. But figure 3.1 below sets out some issues that mortgage lenders and intermediaries might review as they consider what TCF means for their firms, while figure 3.2 proposes a number of issues for insurance firms to consider. We plan to discuss these issues further with firms in these sectors and relevant trade bodies.

Figure 3.1

Mortgages

Product design

- Do firms have appropriate product design and approval processes in place – particularly for more complex or risky products – that support their obligation to treat customers fairly?
- Do firms stress test new products they are designing?
- Have firms considered – especially for more complex products – for which groups of consumers they would, and would not, be suitable?

Producer and distributor responsibilities

- Have firms considered their responsibilities in managing the risks to customers in the context of the relationships between product manufacturers and distributors, and within networks and mortgage clubs?

Figure 3.1 (continued)

Information and disclosure

- Does the firm's material enable consumers to judge effectively the risk/reward balance between different products?
- Where products have particular features – such as extended tie-ins – are these made clear so consumers can understand the implications of these conditions?
- Do lenders test out the effectiveness of their product literature in communicating to consumers?

Special deals

- How early and clearly do lenders tell customers when their discounted or fixed rate is about to end?
- What do lenders tell customers about the new deals that they intend to offer when the current deals are going to expire?
- Do a firm's processes make it difficult for customers to take a deal from another provider?

Remuneration

- Do reward structures encourage sales of a suitable mortgage for a client, as well as discouraging mis-selling?
- Can rewards encourage the sales of mortgages (particularly second mortgages) when other forms of lending may suit a consumer's need better?

Selling and advising

- Do the firm's controls effectively manage the risk that some consumers, such as those with impaired credit histories, may be offered products aimed at non-conforming borrowers, when they could access conventional products that will be cheaper for them?
- Do firms put unfair pressure on consumers to sign up to a deal, for example by checking their credit history while they are still shopping around?

Bundling of products

- Do firms require customers to take other products alongside the mortgage? Are the features of these products made clear to customers?
- Has the firm considered whether its sales processes are adequate to ensure that these other products are properly sold?
- Where products are not bundled, is it always clear to the customer that they have a choice?

Figure 3.2

General insurance

Product design and information

- Are the policy conditions unnecessarily complex and hence difficult for consumers to understand?
- Is the target market for the product clear, particularly for more complex products?
- Are the features of the product clearly and fairly reflected in the marketing material in a way that the targeted groups of consumers can understand?
- Can changes to products – for example limiting exclusions – help reduce the risk that some consumers may subsequently purchase inappropriate products?

Sales and advice

- How comprehensive is the scope of the service that is being provided and is the scope effectively made clear to consumers?
- Is it clear to consumers what information they are being asked to provide in obtaining cover and what the consequences are of a failure to provide comprehensive and accurate information?
- What controls are there to mitigate the risks to customers associated with pay and commission structures?

Producer/distributor interfaces

- Have firms considered their respective roles as producers and distributors of products and their responsibilities in respect of other firms, thereby enabling those firms to treat customers fairly, particularly in the context of managing complex distribution chains involving several parties?
- Do firms have appropriate controls in place from a TCF perspective where product design is delegated to an underwriter?
- Do distributors tell the manufacturers about difficulties with the product (such as lack of consumer – or even adviser – understanding about special conditions or policy exclusions) or concerns about marketing materials?

Claims handling

- Does the firm manage claims handling fairly so that genuine claims are paid properly while firms are taking reasonable steps to address claimant fraud?

Figure 3.2 (continued)

- How do firms assess the value of loss? Is that aspect of coverage clear in the sales process? Is the reason for the valuation effectively explained to the customer?
- Are there controls around the use of loss adjusters so that customers are treated fairly?
- Are firms flexible about how they treat policyholders who notify incidents that do not lead to a monetary claim under the policy? Would firms reduce their no claims bonus in such a case, or would firms disregard the incident?
- Do firms rely on small print to avoid paying out even though it is unconnected with the event that gave rise to the claim?
- Do firms provide adequate information to customers when they make a claim to manage their expectations, for example to help them be clear about the coverage of the policy or about the timescales for processing the claim?

Linked sales

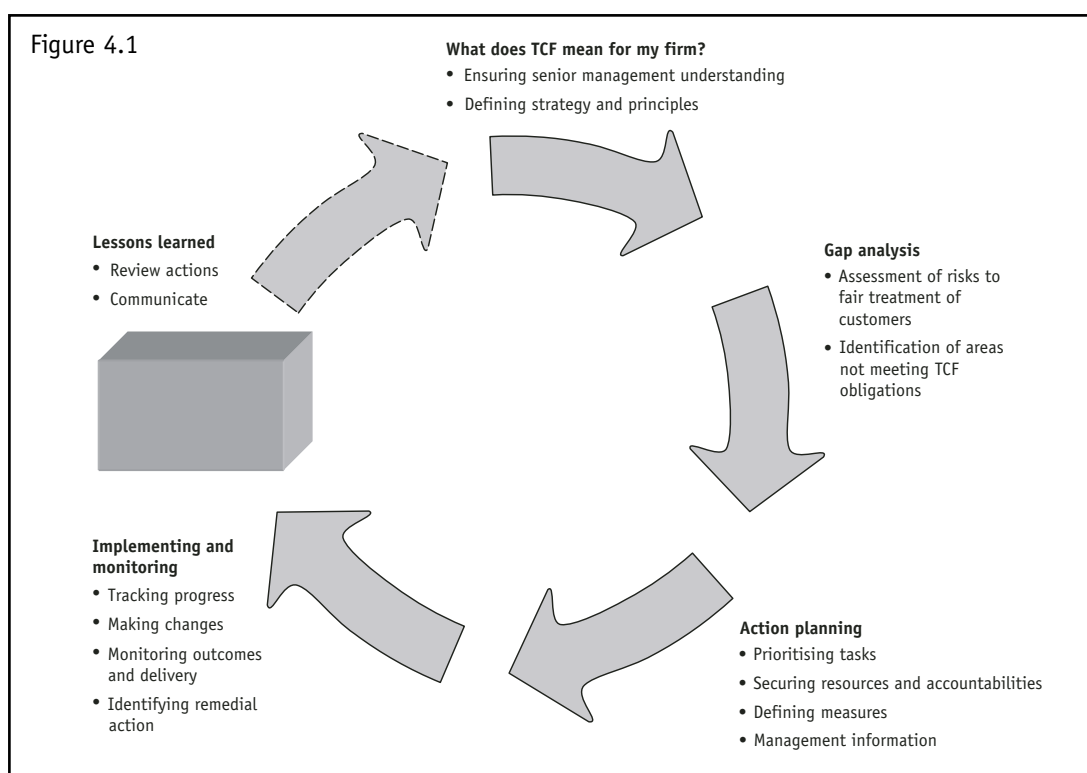
- How do firms manage their sales processes to protect against inappropriate sales of insurance that is bundled with other products?
- Does the sales process reduce the risk of cover being purchased which is unlikely to be of use to the customer? How do firms assess whether a policy is suitable if it is not advising the customer? Do firms take advantage of vulnerable consumers or pressurised situations to offer cover in a way that a consumer may interpret as meaning it is compulsory, even if it is not?

4 Implementing a TCF strategy

- 4.1 All firms have to comply with the principle of TCF, but one size does not fit all. How individual firms approach TCF will depend on their size, management structure, style and culture.
- 4.2 Our July 2004 report said that we expected the senior management of each firm to assess their firm's performance against the TCF requirement, identify possible areas for improvement, and ensure that the principle of fairness is embedded throughout their firm and its culture. Section 5 reports on the progress firms have made.
- 4.3 Firms that have not yet started to develop a TCF strategy might find it helpful to follow a structured approach (see figure 4.1 below). This might cover:
 - defining what TCF means for the firm;
 - assessing current performance to identify gaps where the firm is not delivering TCF satisfactorily;
 - developing an action plan to close any identified gaps and to embed the concept of TCF into the firm's strategy, operations and culture;
 - implementing change through existing programmes or new initiatives; and
 - monitoring the effectiveness of these programmes, using relevant management information.
- 4.4 Such reviews should be proportionate and effective for the firm concerned, reflecting factors such as its size, the challenges it faces and the risk of detriment to consumers. We will expect senior management to be able to explain how they have assured themselves that their firm has embedded fair treatment of customers in its operations. Again, the extent to which senior management will rely on formal structured reports and processes will depend on the nature of the firm and its business.

- 4.5 For the smallest firms, offering limited products or services, we would expect management to have considered these broad stages. But they will often be able to deliver this without the type of structured process and records that will generally be necessary in larger firms. We recognize that smaller firms face particular challenges in implementing TCF, and our plans to help them meet their TCF requirements are discussed in more detail at Annex 1.
- 4.6 Consistent with the fact that TCF is a requirement in our rules and also the responsibility of senior management, we have set out in this section our expectations of firms' senior management. How firms go about delivering that is a matter of judgement for them and it is not a requirement for firms to follow the approach set out here, though they might find it helpful to do so.

A structured approach to embedding TCF



What does TCF mean for my firm?

- 4.7 What constitutes fairness will be different for each firm, depending on their type of business, product and service range, target customers and the channels used to sell or support their products and services. Each firm needs to consider the implications of TCF for itself.

Senior management understanding

- 4.8 Firms are most likely to meet the requirement to treat customers fairly by viewing it as a strategic issue and getting strong leadership from senior management, including the Board.

- 4.9 We have found that senior management in most firms are generally supportive of TCF and consider it part of good business practice. They accept that responsibility for TCF should rest with them.
- 4.10 But beyond this, it is important for senior management to understand what TCF means in practice for their firm, and to demonstrate that they are monitoring its impact on the business. This may involve:
- resolving how TCF applies to the firm's business and target customers;
 - embedding TCF into strategy and culture;
 - assessing how the principle of TCF has been considered and delivered at every level of the firm; and
 - reviewing the firm's performance against its TCF obligations, and addressing any shortfalls.
- 4.11 Any effort by firms to respond to TCF should start with senior management understanding these responsibilities and their implications.

Strategy and principles

- 4.12 The obligation to treat customers fairly should be reflected in a firm's business strategy. However, this needs to be more than just mission statements or values that revolve around putting customers first. Senior management should consider how best to communicate what TCF means for the firm and its customers. This is likely to take into account factors such as:
- the firm's actual and target customer base and their needs, knowledge, sophistication and attitude to risk;
 - the risk and complexity of the products and services the firm offers;
 - past promises or commitments made or implied to customers, and what is required to fulfil these;
 - distribution channels used and their suitability for particular products, services and customers; and
 - business partners that will be part of delivering products and services to consumers, and how they may have an impact on the risk of not treating customers fairly.

Gap analysis

- 4.13 Firms should assess all parts of their business to understand where there is potential risk to the fair treatment of customers and to identify any areas where they may not be meeting their obligations. They might also find it useful to review current policies and working practices. Some areas that firms may wish to consider include:

- product and service design and governance;
- financial promotions and advertising;
- sales and advice;
- information and services provided after the point of sale;
- complaint-handling procedures;
- culture and behaviours; and
- management information.

Action planning

- 4.14 On the basis of such analysis, senior management needs to address any gaps they identify. Change may take time in some areas. But where action is needed, senior management needs to agree and implement a plan to address priority areas first, and mechanisms need to be built to allow it to track that progress is being made as planned.

Implementation and monitoring

- 4.15 Some firms have set up a ‘TCF Project’ to implement any required changes; others have used existing programmes or other mechanisms. Smaller firms may take a much less structured approach.
- 4.16 It is important, however, that:
- senior management maintain control and oversight of the programme;
 - the change effort is appropriately prioritised and resourced; and
 - management information is available to track improvement, with corrective action taken where necessary.

When should firms start to act?

- 4.17 Firms should already have begun to consider the implications for their business. From September 2005 our supervisory staff will increasingly be asking firms – including as part of the ARROW risk-assessment process – how they are meeting the requirement to treat their customers fairly. We expect firms to have considered senior management’s responsibility for TCF, how this will be governed and what TCF means in terms of the firm’s business and customer strategy. Where gaps have been identified, firms should be actively considering how to close them.

5 Industry progress

- 5.1 Our work – particularly with the large and medium-sized firms² – shows that a significant number of firms have begun to consider the implications of TCF for their business. As a result, many of these firms have identified changes which need to be made. Progress in considering the implications of TCF and the changes required appears to have been fastest among the largest firms, with medium and smaller firms (the latter assessed on the basis of limited information) generally some way behind.
- 5.2 In general, most larger firms consider themselves well placed to embed the principle of TCF in their business. While some firms believe TCF is already established in their culture and business, most recognise that more needs to be done to deliver TCF throughout their operations.
- 5.3 Most firms we looked at are either at the strategy and planning stages or working on the implementation of their programmes. But a small number of them have yet to consider the implications of TCF in any detail.
- 5.4 While recognising that firms will use a variety of methods, tools and sequencing, we have used a simple categorisation to review progress across different firms:
 1. Aware
 - analysing the situation.
 2. Strategy and planning
 - determining the extent of any change required within the firm,
 - articulating that change,
 - involving the key players,

2 In Autumn 2004, we surveyed a sample of 33 major retail groups to find out how they had been considering the implications for their businesses of TCF and what changes they considered necessary to ensure that they delivered TCF. This Spring we followed up that work and extended it to cover a further 30 large and medium-sized firms. This was in addition to the firms reviewed as part of our cluster work (see Section 3).

- communicating,
- undertaking a gap analysis.

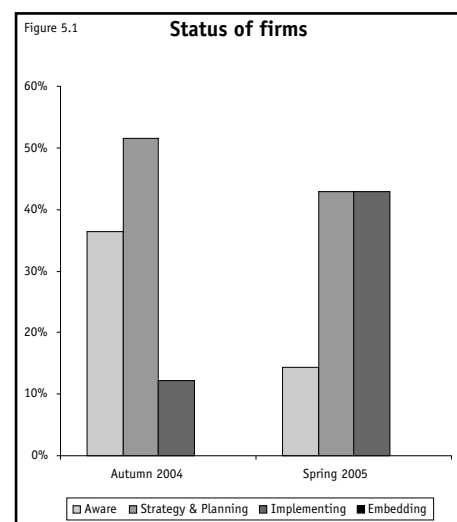
3. Implementing

- allocating resources and responsibilities,
- developed plans and processes,
- creating capability (for example training).

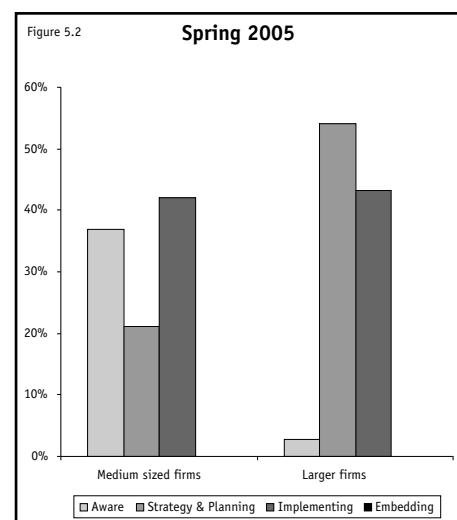
4. Embedding

- conducting reinforcement exercise through evaluation of, and modification to, existing TCF practices.

5.5 Figure 5.1 shows the progress made between Autumn 2004 and Spring 2005. While the sample sizes are different, there clearly is a general shift from the awareness phase (comprising 36% of firms surveyed in Autumn 2004) into either the planning or implementation phases (86% of firms surveyed in Spring 2005). None are yet in the embedding phase.



5.6 Figure 5.2 looks at the progress by major groups compared to other firms covered by our Spring 2005 survey. A number of the larger firms remain in the strategy and planning stage, but there is evidence that in some cases this is because they are undertaking very detailed gap analyses, which may enable them to develop a more comprehensive TCF strategy in the long run.



5.7 A number of common issues emerged from this work.

Senior management support

5.8 The TCF initiative is now more visible to senior management, and most firms have already given their Board a briefing on TCF, or are about to. Some have given formal presentations, while others have given the Board the material we have produced. Firms that have not already done so should consider the extent of Board involvement and support needed for the principle of TCF to be fully reflected in business strategy and monitored by senior management.

TCF consistent with business strategy

- 5.9 Most firms feel that TCF fits well within their overall strategy. Many espouse brand values with concepts similar to fairness to their customers. One firm reported that its key business values are already consistent with TCF, but that they are looking to make this more explicit to their staff. Management in another firm felt that TCF is more than a regulatory initiative. An internal memo from the CEO stated:

'I would (...), emphasise that this is not something that we see as being driven by the regulators but an essential part of the way we wish to do business'.

- 5.10 Firms predominantly see the TCF agenda as being something which needs to be a 'business' driven rather than a 'compliance' driven initiative. Some firms have commented that they have defined a distinct and separate TCF strategy, incorporating their vision of 'fairness', while others have incorporated their TCF strategy into their customer service values.
- 5.11 Some firms have set up specific TCF projects, while others have linked TCF to a wider corporate change programme. These programmes are generally aimed at rolling out or supporting brand values or 'customer management', rather than being compliance driven initiatives. Some firms prefer not to use the 'TCF' branding but use their own language, or feel they will get better buy-in from staff by linking TCF to their existing philosophy and branding.

Governance

- 5.12 Initial approval of TCF strategy has generally been given either at Board or senior management level. But firms are generally putting in place specific arrangements for governing their programmes once approved. Larger firms, in particular, have decided to set up a high level steering committee of senior representatives from parts of the business relevant to TCF. This committee then typically oversees and coordinates the detailed work of the various business units.
- 5.13 Most medium-sized firms see TCF as the collective responsibility of the firm's management. However, a number have taken the additional step of making a senior individual responsible for overseeing the implementation of TCF. This varies from marketing director or corporate responsibility director to compliance director, often supported by a senior project manager. Several firms reported that their CEO has taken personal responsibility for the TCF project, and that this has helped to maintain momentum and commitment to any necessary changes.
- 5.14 Where firms are implementing changes identified as necessary to deliver TCF, it is important that such work is led, and seen to be led, by senior

management. Whatever governance a firm has in place, it is clear that buy-in by senior management is critical for the successful implementation and embedding of TCF. Where compliance areas are currently in the lead, firms found it helpful to have a plan to move to a joint approach with the business.

Training and communication

- 5.15 Overall, firms had less to report on what they were doing, where necessary, to effect cultural change, specifically in terms of people issues, training and communication. Some firms have included human resources activities in their TCF plans and are building TCF considerations into areas such as training and competence, remuneration, performance management and promotion.
- 5.16 Several firms had reviewed their training material and included TCF as a core topic, and incorporated it into their induction training. To raise the profile of TCF, one firm is running roadshows, at which the CEO will speak, for 4,000 staff. Another firm is running ‘excellence in claims’ training to support good claims handling with a focus on TCF issues. Other firms are yet to develop their thoughts on training, but tell us they intend to do so.
- 5.17 Firms are at varying stages of communicating TCF to their staff. Some firms have gone no further than discussing TCF with members of the project team. Others have issued communications to all staff. How firms communicate also depends on the firm’s organisation and approach. Where a firm is integrating TCF into an existing corporate change programme, some have concluded there is no reason for the majority of staff to receive specific communication on TCF, because the necessary messages can be conveyed through the programme.
- 5.18 Buy-in and engagement from staff on the ground is necessary if the senior management’s high level TCF objectives are to be delivered, no matter how the work is ‘branded’ in the firm. Front line staff can provide valuable feedback for management, indicating success in delivering TCF and identifying ways that this could be improved.

Examples of current industry practice

- 5.19 During our work we have found examples of good TCF practice, as well as instances where the principle of TCF is not being applied.

Not automatically bundling loan protection insurance

A major bank has decided to change the way it sells general insurance products alongside other banking services such as personal loans and mortgages. Previously, it would have a working assumption that customers would want to take a linked insurance product with the loan, unless the customer asked not to. Now it will assume the customer does not want the insurance cover, unless they positively choose to take it.

Not considering implications for customers

A firm recently introduced a new mortgage product, with a high maximum loan to value ratio, to be sold through intermediaries. While the firm's product analysis was extensive, it was focused primarily on the risks to the firm, giving limited consideration to the implications for the customer if house prices fall and the customer is unable to keep up the loan repayments.

Annual monitoring of product range

A bancassurance group has decided to do an annual product review of all its retail products, assessing each against criteria such as:

- whether it still meets the needs clients bought it for;
- whether it still meets the group's performance requirements; and
- whether sales are being made to the target customer segments.

Findings will be reported to the group board.

Proactively informing customers of their options

A life insurer has decided that it should write to all its with-profits policyholders in advance of spot dates when they can access their money without a market value reduction being applied. The firm wants its customers to be able to take advantage of this opportunity.

Responsible lending to help customers avoid excessive interest charges

A bank was concerned that some of its customers had built up large credit card debts, which were rolling over from one month to the next at relatively high interest rates. The bank has decided to contact these customers to suggest that they could save money by transferring the core debt to a personal loan at a lower interest rate. The bank will also review card limits to help its customers.

Keeping customers informed of changes in interest rates on mortgages

A major mortgage lender identified that customers were shocked when a fixed rate on mortgages came to an end. While it recognised that this would be unpopular news, the firm decided that it should give customers more notice of when the interest rate would rise, so that they had more time to respond and decide whether to remortgage. This strategy risked encouraging customers to move to other lenders, but the firm chose to consider the customer and gain the reputational benefit.

Setting expectations for insurance claims

An insurer was getting complaints from policyholders whose claims were being rejected some weeks after they had been submitted. It found that policyholders assumed that the process of the call centre taking their details meant that the company agreed the loss was covered by the policy. This raised false expectations. The insurer has now put technical staff into the call centre, to tell policyholders at the outset whether or not the claim is valid and why.

Investment advisers handling complaints in a threatening manner

An investor was unhappy with the recommendations he received from an independent adviser, and felt that he had been wrongly advised to buy a high risk investment. The firm rejected the complaint out of hand, suggesting that the investor would not be able to prove that the product was mis-sold. It also told the investor that although he could take his case to the Financial Ombudsman Service, if he did, the firm would go to the police and accuse the customer of making fraudulent claims.

Encouraging better compliance from Appointed Representatives

An investment firm introduced a new risk assessment model for its advisers – it now allocates compliance office resources depending on the level of risk associated with each adviser. The costs of that compliance monitoring are charged to the individual adviser and set against the commissions earned from product sales. The adviser only gets a bonus once the compliance costs have been recovered.

Defining requirements from a product manufacturer to meet customer needs

A building society decided to tie up with an insurance provider to offer a range of products for unsophisticated investors. It saw this as an opportunity to benefit its customers, and specified the kind of simple products that its customers would want. It also specified the quality standards that the provider must meet, and will monitor the insurer's performance to make sure it delivers.

Co-operation between distributors and product providers

One provider has set up a joint management committee with its main distributor, to discuss and resolve issues arising from the relationship.

Lack of clarity to customers

A general insurance firm has been operating with an Appointed Representative – with a strong and trusted brand identity – to sell certain insurance products. But the marketing literature it produces for the Appointed Representative to use does not make it clear who the insurance policy is with.

Trade bodies

- 5.20 We have seen many trade bodies working with their members over the last year to raise awareness of TCF and share ideas on how firms in their sectors can take TCF-related work forward.
- 5.21 Some associations, such as the Association of Independent Financial Advisers and the Association of Private Client Investment Managers and Stockbrokers, have prepared TCF fact sheets for their members. Using the information we have produced, among other things, they have related some of the TCF material to the business of their member firms to help them understand what TCF means for them. The Building Societies Association has prepared a detailed manual for its members.
- 5.22 Some trade associations have organised and facilitated discussion groups for member firms. An example of this was a British Bankers' Association discussion group covering how firms could measure success in implementing TCF, and the information firms would need to collect to evidence this. The Investment Management Association has begun a series of workshops for firms to discuss the practical implications of TCF. The Council of Mortgage Lenders has run a series of regional seminars. Such events give firms with common interests an opportunity to debate problems they have encountered, share ideas and identify common solutions.
- 5.23 The Association of British Insurers has been working with its members on a range of measures to improve the performance of their member firms. Its 'Five Point Plan' includes a range of commitments aimed, among other things, at delivering high standards in the life insurance sector and ensuring that firms communicate regularly and clearly with their customers.
- 5.24 We welcome these initiatives and the efforts of trade bodies such as these to communicate with firms about TCF and what we expect. This is particularly important to us when it comes to the firms that we have less day-to-day contact with, such as smaller firms.

6 Other issues and next steps

6.1 This section is in two parts. The first considers the relationship between TCF and certain other areas of our work, including:

- our approach to supervision;
- enforcement for TCF failings;
- consumer research;
- TCF and the Handbook; and
- TCF and unfair contract terms.

6.2 The second part outlines our plans for taking TCF forward.

Part 1

Supervision

6.3 Over the next few months, reviewing the approach firms have taken to ensure they embed the fair treatment of customers into their operations will become a core part of our regular risk-assessment process (ARROW) for firms (with a relationship manager). We accept that with a principle-based approach there may be genuine differences of view as to what behaviour is acceptable and there may need to be a discussion between firms and ourselves when such differences arise.

Enforcement

6.4 The principle of TCF is a rule in the Handbook. We have in the past taken, and will continue to take, enforcement action where breaches of this principle by firms result in significant consumer detriment.

6.5 As we have explained, ensuring that TCF is built into a firm's operating procedures should minimise the risk of consumer detriment.

6.6 Where firms identify shortfalls in their current practices, we expect firms to put in place plans to address them, starting with the highest priority issues. Supervisors will be looking to see whether, in these circumstances, firms are taking proportionate action to address the gaps and to remedy any adverse impacts they have upon their customers in the short term.

- 6.7 When our supervision work in future identifies failings in TCF in a firm, we will consider the most suitable course of action. In many cases, we will agree with the firm how it intends to address the shortfalls and, where necessary, give customers redress when the failings have resulted in a loss to them.
- 6.8 In some cases, failing to treat customers fairly may lead to us taking enforcement action that could result in a public censure or a penalty. In deciding whether to take such action, we will take into account a number of factors, including whether:
- the firm has considered the implications of TCF to their business; and
 - senior management have played the role we expect of them in relation to TCF.
- 6.9 Where a firm has not responded to indications that there are problems, has failed to identify shortcomings where they exist and to develop a strategy to remedy them, and has committed a serious breach of the principle, we will be more likely to take enforcement action.
- 6.10 But we do not expect to take enforcement action when firms have made a genuine attempt to deliver on what they consider TCF means for them and there has not been significant risk to consumers.

Consumer research

- 6.11 To support our programme of work, we carried out consumer research on consumers' attitudes towards fairness in financial services. When asked to identify basic principles that they would regard as being central to fairness there was considerable agreement over the key factors set out below:
1. give the customer what they have paid for;
 2. do not take advantage of the customer;
 3. offer the customer the best product you can;
 4. do your best to resolve mistakes as quickly as possible;
 5. show flexibility, empathy and consideration towards customers; and
 6. exhibit clarity in all customer dealings.
- 6.12 The findings are summarised in Annex 4. Full details of the research are on our TCF website.

TCF and review of the Handbook

- 6.13 We will continue to adopt a principle-based approach to TCF.
- 6.14 We are carrying out a general review of the Handbook, to identify any requirements that are no longer necessary to achieve our objectives. This work includes a special focus on the Conduct of Business sourcebook. Our intention is to simplify this, consistent with our principle-based approach to TCF.

- 6.15 In due course we will consult on removing detailed rules where it would be more appropriate to rely on high-level standards. We will propose this sort of change where we see benefits from focusing our attention on senior management responsibilities, and allowing firms greater scope in deciding how to comply with our high-level rules. We recognise that how firms comply with these rules will depend on factors such as the nature and size of their business, and would not expect greater reliance on senior management responsibility to increase the overall burden placed on firms.

Responsibilities of Producers and Distributors

- 6.16 As noted in our cluster work (see Section 3), we have looked at how, in practice, firms have managed their respective responsibilities and what further steps they take to protect customers. But the division of responsibilities is less neat than it initially appears and we have decided to carry out further analysis over the next year that will test the appropriate balance in this relationship. This will include:
- examining the implications of the *Seymour v Ockwell*³ case and testing whether it has broader implications for our regime;
 - drawing out the lessons from losses suffered by retail consumers in several examples of Structured Capital at Risk Products (SCARPS); and
 - considering to what extent stress testing can and should be used as a tool by producers of products to help ensure that products perform well in bad times (for instance following a large fall in the stock market or increase in interest rates) as well as good.
- 6.17 We will consider whether any further work may be needed when we have completed that analysis.

TCF and the Unfair Terms in Consumer Contract Regulations

- 6.18 The Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR) provide that unfair terms in consumer contracts are not binding on the consumer. A term can be unfair if it has not been individually negotiated and it causes a significant imbalance in the rights and obligations of the firm and the consumer.
- 6.19 We have published a Statement of Good Practice on the need to treat consumers fairly when drafting such clauses, www.fsa.gov.uk/pubs/other/good_practices.pdf. This is being followed by discussions with the leaders of relevant industry and consumer bodies. In addition, we have published on our website undertakings from firms to stop using, or to amend, unfair terms in their contracts. This will allow both firms and consumers to understand better the problems and how they can be resolved.

3 *Seymour & Seymour v Caroline Ockwell & Co and Zurich IFA Limited*. This is a case about the duty of care owed by a financial adviser to its clients and also the duties owed to a financial adviser by a product provider.

- 6.20 The regulations and TCF are fully compatible. Both regimes operate on the basis of a judgement about what is fair. The UTCCR are narrowly focused on the question of whether a particular term in a particular arrangement is unfair. The principle of TCF is a broader concept which is focused more on the general approach of the firm, as delivered by its culture and its systems and controls, and the care it takes in its dealings with its customers. It is therefore possible that, even if a firm included a term in a contract that is later found to be unfair, for example through a one-off misjudgement, we would not necessarily consider that the firm had breached the principle of TCF.
- 6.21 Annex 5 covers this issue in more detail and discusses the relationship between TCF and other consumer-facing legislation which relates to fairness.

Part 2

Next Steps

- 6.22 We will retain a central TCF team to lead on our work internally and to oversee our TCF strategy and communication programme.
- 6.23 An early priority for the team will be to organise a TCF conference later this year. Full details will appear on our TCF website.
- 6.24 We will carry out further ‘cluster’ and other work related to TCF. We will continue to develop our website material on TCF which will provide more detailed assistance to firms concerning good and bad practice. We will invite comments from our Consultative Group on further topics. We plan to review:
- the way in which different groups of firms have gone about considering their TCF responsibilities and will provide feedback on this;
 - the progress firms are making in identifying the MI that they need to monitor their success in delivering TCF strategies; and
 - the quality of advice being given to customers.
- 6.25 As we build TCF into our routine supervision work – including through ARROW – we will develop further training which we will roll out later this year. This will focus on helping supervisory staff to adopt a principle-based approach to their work and to take a consistent approach across different firms. We will discuss these plans in more detail with the TCF Consultative Group.
- 6.26 We will help smaller firms to address TCF. We will do this by taking account of TCF in developing plans for thematic work directed at smaller firms. We will also look to raise awareness of TCF with smaller firms at regional seminars, and through our newsletters. This is discussed further in Annex 1.
- 6.27 We will carry out more work on the responsibilities of firms acting as producers of products and firms acting as distributors.
- 6.28 We will publish a further paper on TCF in the first half of 2006.

TCF and smaller firms

1. Customers are entitled to the same degree of protection no matter what size of firm they do business with. The principle of TCF therefore applies to all firms regardless of size, and we expect smaller firms to comply with it.
2. How firms translate the principle of TCF into practice, and the amount of resource required, will vary. Smaller firms may have significantly less management resource to devote to governance arrangements and less financial resource to devote to systems and controls. The objective of our programme is to bring about a change to the retail marketplace that will benefit consumers – we have never intended that TCF should become an exercise in form filling or an unwelcome distraction for management. Proportionality is key.
3. There is no standard way in which TCF should be applied – smaller retail firms' business models and the range of their activities are too diverse for there to be a single approach. But we recognise that it is important for us to help the management of smaller firms work out how the principle of TCF applies to their business, and our discussions with trade associations representing smaller firms have been very helpful.

Ways in which smaller firms may differ

4. We recognise that there are differences between large and small firms. Some of these differences include:
 - Small firms typically have fewer layers of management. In theory, this can make it easier for management to ensure that their staff adhere to the principle of TCF. For this reason, some of the wider corporate governance issues, and our concerns relating to the adequacy of high-level systems and controls and management information, may seem less relevant. That said, small firms still need to have adequate controls over their staff and, where relevant, Appointed Representatives. Furthermore, there are areas where having fewer staff may pose greater challenges for management who do not have separately resourced internal control functions.

- The majority of small firms are not product providers, so the management of many of those firms may feel that the material about the product design process may not be directly relevant. But for those small firms that are product providers, control over the product design process is essential. And even those firms providing services to clients may want to consider some of the product design issues as they bring new services to market.
 - A frequently-observed feature of small firms is a long-standing client base and a high level of knowledge about individual clients and their needs. But our investigations show that having a small client base does not always mean client needs are better understood, or TCF better addressed.
5. Therefore, while there are some differences in the way small firms operate and how they go about meeting their TCF obligations, two key requirements remain:
- Management should be fully involved in considering what TCF means for their business, and establish an appropriate culture for their firm.
 - For firms involved in providing products and/or services to consumers, the principle of TCF needs to be upheld throughout the process – from designing services or products, marketing and promotions, and giving advice to selling and providing help after the sale, such as handling complaints.

Practical considerations for smaller firms

6. The Handbook outlines rules and guidance covering many aspects of how we expect firms to behave and supporting our objective that firms should treat their customers fairly.
7. However, TCF is not only about compliance with the detailed requirements set out in our rules. It is also about firms acting to observe the spirit of what our rules aim to achieve. Management should consider whether compliance with specific rules is always sufficient to deliver TCF. Rules cannot cover every possible situation.
8. Smaller firms should therefore consider and be able to explain how the principle of TCF applies to their business. Section 4 of this paper gives a model that some firms find helpful. Essentially, it describes how a firm can step back and look at its operations, identify areas of potential risk to its customers, and consider how to remove or mitigate these.

9. While Section 4 describes processes, we do not necessarily expect smaller firms to undertake an elaborate review involving consultants. But given the problems across the financial sector in recent years, we think it is reasonable to expect firms to take an objective look at the way they do business, to help identify areas where operating standards need to be strengthened. Smaller firms may find it helpful to use the framework in Section 4 to structure management discussions of TCF.
10. We recognise that smaller firms may not have a documented strategy or detailed files evidencing how they deliver on TCF. But management should be able to describe their strategy and how TCF fits with it. Where applicable, management should also ensure that the principle of TCF is understood by relevant members of staff and that their behaviour takes account of the needs, risk appetite, level of understanding and rights of their customers.

Issues for consideration

11. Our rules already set out to some degree how regulated firms should conduct themselves. Many smaller firms are advisers, so various practical aspects of their operations will already be shaped by the requirements of our conduct of business sourcebooks for investment, insurance and mortgages. But sourcebooks do not cover every aspect of a firm's operations. Even where firms are subject to those rules, we would still encourage management to consider if TCF is properly reflected in their businesses.
12. All smaller firms should at least review whether the structure of the firm positively supports the principle of TCF as well as compliance with detailed rules. A good example might be whether the remuneration structure encourages the right kinds of behaviour. Other areas that firms might like to think about are outlined below.

Financial promotions: During any marketing or sales activity, financial promotions of any sort, including bespoke material such as suitability letters, must be clear, fair and not misleading,

Advice and sales process: Management should ensure that advice is appropriate and timely for the particular sale, that due account has been taken of the profile of the customer, and that the customer's needs, knowledge and attitude to risk have been adequately assessed and taken into account. Firms must also disclose information to their customers in ways that comply with our rules and requirements.

Practices clearly resulting in a bad deal for consumers include firms failing to demonstrate responsible advice. We have seen customers being sold sub-prime mortgage products when prime products were available to them.

Our priority in relation to mortgage and general insurance firms is focusing on the standard of disclosures to consumers. While the Key Facts requirements have only been in place for a few months, standards of disclosure by mortgage intermediaries are not high and we will be working intensively over coming months to raise standards.

But we also see firms taking steps, beyond the requirements of our detailed conduct of business rules, to make sure they treat their customers fairly. We have seen a general insurance intermediary that uses a warning notice to draw attention to exclusions in policies, rather than embedding them in small print. This is embracing the spirit of TCF and placing the welfare of the customer at the forefront.

Another firm changed its practices when alerted to the fact that customers might have been disadvantaged. A sole trader had been recommending his clients to invest in a bond where he thought capital was guaranteed. On discovering that this was not the case, he contacted each client affected, explained the situation and arranged for them to take appropriate action. He paid compensation where appropriate, and continued to have very good relationships with his clients.

Training: The ability of staff to offer customers the appropriate standard of service obviously depends on how well they are trained. Few smaller firms have dedicated training functions, so it is important for management to be satisfied that staff have the necessary skills and competence. This applies to all staff who may have an impact on whether customers receive fair treatment, including those involved in sales, marketing, complaints handling and compliance. Management should also be realistic about the potential limitations of training offered by product providers.

Information issued by product providers: It is for product providers to provide clear and relevant information about their products to distributors. But it is important for distributors to consider the information they are given. By this we do not mean that financial advisers have to second guess the actuarial assumptions underlying the design of a product, but they should be able to form a judgement about, for example, whether the material is suitable for use by their clients. Management and staff involved in marketing or selling should understand the features and risks associated with the products they handle. If they do not, they should not be selling the products. This is essential if products are to be explained adequately to customers and advisers are to be certain of their suitability. Advisers should also be able to make an informed judgement on whether they agree with opinions expressed in providers' literature.

Accurate and timely record keeping: This is an area that can suffer at firms with few staff, especially at one-person operations. It is nevertheless important that firms maintain adequate records of customer profiles and instructions, and on each stage of the sales process. This is essential for management to be able to respond fairly when disputes arise, and will help if they have to provide evidence to the Financial Ombudsman Service (FOS).

Disputes and complaint handling: Smaller firms need to attach the same importance to the fair and effective resolution of complaints as larger firms, which may have dedicated complaint-handling functions. Smaller firms are often closer to their customers and may be better placed to resolve any complaints; but they need to be aware of the potential risks when the person handling the complaint could also be responsible for the advice.

A client complained to his financial adviser that he had been charged a surrender penalty when he cashed in his life policy. He complained that the adviser had not told him, when he bought the policy, that a penalty could be charged. After investigating the complaint, the firm accepted that it had given poor advice. The investigation also revealed that the policy was probably unsuitable for the client and that he had suffered a much greater loss than the penalty he had first complained about. But suspecting that the client was unaware of the wider problems, the firm only offered to reimburse him for the cost of the surrender penalty. It did not tell him that the original advice had been unsuitable and that the potential loss to him may have been far greater than the amount they had offered. The client was therefore unable to take an informed decision when deciding whether to accept the offer.

Flow of information between a firm and its clients: A particular feature of many smaller firms is that they have close and long-standing relationships with their clients. This may give the customers many benefits, but it can also result in the flow of information between firm and client becoming less formal, both at the point of advice or sale and afterwards. It is important that customers remain clear about the nature of the services being offered by the firm. Management may want to consider how to keep customers properly informed during the course of an ongoing relationship. Firms need to ensure that they always act with integrity in their dealings with customers, regardless of the length of the relationship.

Risk assessment: Although the practical implementation of TCF may be less formal, the management of smaller firms should still review all aspects of their business and organisational structures to identify risks that might have an impact on their ability to treat customers fairly. Management should then act to mitigate any such risks.

A risk that already concerns us is the poor level of control exercised by general insurance intermediaries over Appointed Representatives. Our supervision work is targeting the potentially serious consequences for customers.

We also see evidence that some firms are putting themselves into administration to avoid their liabilities, only to re-incorporate as a separate legal entity (a ‘phoenix firm’) and carry on trading. We have devised an approach to deal with these situations, so that any claims arising are dealt with appropriately and customers are treated fairly.

TCF objectives and management information (MI)

13. We expect the management of smaller firms to determine what TCF means for their business and decide what they need to do to deliver that. This need not be complex. For example, a financial adviser might aim to:
 - sell products that are suitable to the needs, wishes and financial sophistication of its clients;
 - ensure clients receive all necessary information about the service offered by the adviser and on any products recommended by the adviser, and that this is explained in a way that is understandable to clients; and
 - handle complaints fairly.
14. Having set their objectives, management should decide how the firm will achieve them and how this will be monitored.
15. Our focus on MI and performance measurement is because we consider it important that management should be able to access MI to assess whether the firm is successfully meeting its TCF objectives. The MI that firms gather need not be complex or require expensive systems, but should be proportionate and sufficient to inform management whether the business is delivering TCF in the way they have defined it. So, for an advisory firm, relatively simple data about sales, persistency and complaints (which the firm already has) could provide many of the answers.
16. Having the appropriate MI will help management know if they are delivering their strategies and help them identify gaps where further work is needed.

Assisting smaller firms in meeting their obligation to TCF

17. We do not have day-to-day contact with smaller firms and we may not visit them on a regular basis. Instead, we will generally contact them:
 - to give them information which we think they might find useful, about good and bad practices we have seen in the industry, or other relevant FSA developments;

- when we need to follow up any information we have received about them; and
 - to ask them to participate in our thematic work.
18. However, there are other ways in which we communicate with smaller firms and we have initiatives to make us easier for smaller firms to do business with. These include our Firm Contact Centre and Firms Online, a system that allows firms to submit returns, make applications and change their details electronically. We have also begun a series of visits, roadshows and surgeries around the country at which firms can ask questions. We are running a series of industry training events and there is much useful information on our website, including dedicated pages for mortgage and general insurance business and a tailored version of the Handbook. All these channels of communication will help smaller firms to have a good understanding of their TCF responsibilities and the issues they may wish to consider in meeting them.

Next steps

19. We will continue to develop our thinking about how TCF applies to smaller firms, and in this we wish to work closely with the relevant trade bodies and industry representatives. In addition to our work on TCF for smaller firms, we will continue to consider TCF issues relevant to specific industry sectors, some of which – particularly in the advisory sector – are closely linked to smaller firms.
20. We will communicate the results of our supervisory work on smaller firms, most of which relates to ensuring that their customers receive a fair deal. In this way, we intend to provide clear statements to help smaller firms consider what TCF might mean for them.

TCF Consultative Group

1. The role of the group is to provide a forum to discuss TCF issues, including commenting on the results of the FSA's work. It has met six times, with a special one-off session in February 2005 to discuss TCF and smaller firms.
2. The group comprises representatives of trade associations from a range of key industry sectors, consumer groups and other interested parties, including our Consumer, Practitioner and Smaller Businesses Practitioner Panels.
3. To keep the group to a manageable size, certain individuals represent other interested parties. We have also had separate discussions with other trade bodies on issues of specific interest to their members.
4. The participants are as follows.
 - Association of British Insurers (ABI), also representing the Association of Mutual Insurers and Association of Friendly Societies
 - Association of Independent Financial Advisers (AIFA), also representing the Association of Mortgage Intermediaries
 - Association of Private Client Investment Managers and Stockbrokers (APCIMS), also representing the Association of Investment Trust Companies
 - British Bankers' Association (BBA), also representing the Association of British Credit Unions
 - British Insurance Brokers' Association (BIBA)
 - Building Societies Association (BSA)
 - Council of Mortgage Lenders (CML)
 - Investment Management Association (IMA)
 - Personal finance journalist

- Which?
- Financial Ombudsman Service (FOS)
- Financial Services Consumer Panel
- Financial Services Practitioner Panel
- Smaller Businesses Practitioner Panel

TCF website materials

There is feedback on our supervisory work, including reports on the six clusters, and the case studies on our website (www.fsa.gov.uk/tcf). This includes:

Reports on supervisory clusters

- Product design
- Management information
- Remuneration
- Strategic change
- Complaints management
- Interfaces between providers and distributors

Feedback on other supervisory work

- Progress in implementing TCF among larger firms
- Progress in implementing TCF in some medium and smaller firms

Report of our consumer research

Case studies

- **Product design** – uses the example of a bancassurer launching a new product, to consider safeguards to help ensure the product is fit for purpose and sold to the target market.
- **Managing strategic change** – explores the issues considered by senior management of a small IFA firm before it decides to ‘multi-tie’, and as it does business with existing and new customers as a multi-tied adviser. It also outlines how the firm reviewed the impact of the change on its customers.

- **Controls within networks** – uses the example of a network of financial advisers, to consider the measures a firm might implement to ensure that its appointed representatives act in accordance with the firm’s TCF obligations.
- **Complaints handling** – looks at how a firm of independent financial advisers developed a more effective approach to complaints handling.
- **Managing conflicts of interest** – looks at a stockbroking firm that offers investment advice to private clients as well as undertaking research, to consider how conflicts can be managed.
- **Managing unexpected events** – concerns a small product provider that discovers it has a problem with a legacy system which could have led to an investment product being mis-sold, and reviews how the firm assesses the scale of the problem and addresses it.
- **Information after the point of sale** – looks at a bancassurer which encourages staff to keep customers as the focal point of their work. The firm reviews its business processes, its ideas about a range of communications, customers’ needs, staff training and handling external changes, for senior management to consider.
- **Remuneration** – considers how a bank’s remuneration structure could incentivise its staff in the wrong way. It suggests reward structures that might encourage more TCF compatible behaviour by staff.
- **Management information** – explores how a composite insurer undertakes an assessment of the information it needs and how it will collect and use it.

Consumer research

Approach

1. Much of our work, such as the supervisory clusters, focuses on what TCF means for firms. But our ultimate objective is to deliver a better environment for consumers. So, we decided it was important to be able to take account of consumers' views in our TCF work to help us identify priorities. Rather than relying on our own and others' perceptions, we commissioned independent research on consumers' perceptions of fairness in the financial services sector.
2. We discussed the scope of the work with the TCF Consultative Group and early in 2005 we commissioned an independent consumer research firm to explore the perceptions of a representative range of consumers.
3. The research firm's samples covered a broad range of consumers, with varying degrees of experience of different product types and drawn from a range of ages and socio-economic groups. Interviews were conducted in a number of cities across the United Kingdom.
4. The sampling captured a range of views that we think are broadly representative of typical consumers. Participants were encouraged to discuss their general views and experiences of fairness in their dealings with firms, as well as specific issues relating to financial services and products. The report of the findings, with further information about the methodology, is published in full on our website.

Key findings in attitudes towards fairness

5. The research suggested that consumers fell into three broad groups and this was the key factor that influenced their responses. Factors such as age and wealth had no material bearing on the respondents' view of fairness. There was considerable commonality across the different groups in certain areas. Respondents found it difficult to distinguish fairness from issues such as ethics, customer service and genuine errors. They therefore tended to regard any instances where things did not go to plan – whether as result of poor customer service, a mistake or even rudeness – as being unfair.

6. The overriding influence on respondents' attitudes was what the researchers referred to as 'financial sophistication'. The researchers defined this as a function of personal factors such as experience of financial services and willingness to participate in financial transactions. At one end of the spectrum of financial sophistication, the researchers identified a segment of consumers that they referred to as 'dependent'. These people were aware that, for a variety of reasons, they lacked a full understanding of the financial services market. They also recognised that they were at risk of being treated unfairly. At the opposite end of the spectrum, the researchers identified a group they referred to as 'expert'. This group tended to view financial services as a logical and rational relationship between a firm and its customers and so did not regard fairness as an issue. Most consumers appeared to be in a category which the researchers referred to as 'mass market'. These consumers tended to consider that there was unfairness in a range of financial transactions, which they attributed to inequalities in 'the system'. During the discussions, members of this group were able to start to characterise issues of fairness and to distinguish them from issues such as customer service or supplier error.
7. The findings provided a useful insight into consumers' attitudes to fairness in financial services. The researchers worked with each group to seek to establish a definition of fairness, from a consumer perspective, and to identify what is important in their dealings with financial services organisations. They guided and challenged respondents to help them distinguish issues about the consequences of mistakes from those they felt to be fundamentally unfair.

How do the findings relate to our work?

8. Despite the differences in the responses in the three broad groups, when it came to identifying some basic principles that they regarded as being central to fairness, there was considerable consensus across those groups.

Six key themes for financial services firms emerge from the findings of the research programme on consumers' perspective of fairness (in no particular order)

- Give the customer what they have paid for.
- Do not take advantage of the customer.
- Offer the customer the best product you can.
- Do your best to resolve mistakes as quickly as possible.
- Show flexibility, empathy and consideration towards customers.
- Exhibit clarity in all customer dealings.

9. In general, these conclusions were consistent with our approach to TCF, and other initiatives on our retail agenda, including financial capability.
10. Some of the specific concerns raised by respondents included a concern that they were not able to understand some of the complex features of products. They also felt that the way that financial products and services are advertised and marketed is unnecessarily complicated. As a result, the research suggested consumers are inclined to feel that there is no point in them attempting to understand the products they are buying. Many of the respondents said that they wanted to be more engaged, but for that to happen, they needed firms to present information to them in a way that they could understand.

TCF and other fairness requirements

1. Our TCF work is based on the powers that we draw from the Financial Services and Markets Act 2000 (FSMA) – the legislation which underpins our work.
2. The principle of TCF is not drawn from FSMA itself but is one of the Principles for Businesses that we established under the rule-making powers that FSMA provides. This paper and our other TCF communications are designed to help firms understand what the principle means for them and their business. In some areas, the principle is supported by detailed rules – in particular, those governing the conduct of business for investments, general insurance and mortgages.
3. Other tests of fairness also affect financial services firms. Some requirements to behave fairly are imposed by the industry itself, such as through the Banking Code. The Raising Standards initiative for the life insurance sector operates on a voluntary basis, but has similar aims. We do not analyse those requirements here.
4. There is other legislation that depends on the concept of fairness, and that can affect financial services firms. Two legislative frameworks in particular are relevant:
 - the Unfair Terms in Consumer Contracts Regulations; and
 - the Financial Ombudsman Service (FOS) arrangements.
5. These apply to all regulated firms and sit alongside the regulatory requirements imposed by our rules.

Unfair contract terms

6. The Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR) provide that unfair terms in consumer contracts are not binding on the consumer. A term can be unfair if it has not been individually negotiated and it causes a significant imbalance in the rights and obligations of the firm and the consumer.

7. We can use our powers under FSMA to consider issues of fairness in financial services consumer contracts, whether in the drafting of the contract or the way it is administered.
8. However, UTCCR give us specific powers in relation to contracts which are binding on consumers although they have had no influence on them. The risk is that such contracts are weighted in favour of the firm and do not properly take the consumer's interests into account.
9. We have been focusing our attention on those contracts with a clause that allows the firm to vary the terms of the contract, such as the interest rate or insurance premium. We have published a Statement of Good Practice on the need to treat consumers fairly when drafting such clauses at www.fsa.gov.uk/pubs/other/good_practices.pdf. This is being followed by discussions with the leaders of relevant industry and consumer bodies. In addition, we have published on our website undertakings from firms to stop using, or to amend, unfair terms in their contracts. This will allow both firms and consumers to understand better the problems and how they can be resolved. We continue to work with other relevant organisations, particularly the Office of Fair Trading, in effectively implementing consumer protection legislation.
10. The UTCCR are fully compatible with the principle of TCF. Clearly, both regimes operate on the basis of a judgement about what is fair. The UTCCR are narrowly focused on the question of whether a particular term in a particular arrangement is unfair. However, the principle of TCF is a broader concept which is focused more on the general approach of the firm, as delivered by its culture and its systems and controls, and the care it takes in its dealings with its customers.
11. The Consumer Credit Bill, which has recently been introduced before Parliament, would make similar provisions as UTCCR. This will allow unfair provisions in consumer credit agreements, or provisions that operate unfairly, to be struck out by a court. The judgement would again be on the basis of the specific contractual arrangements.

Financial Ombudsman Service

12. The Financial Ombudsman Service (FOS) was established in line with our duties under FSMA. While the detailed arrangements under which the FOS operates are set out in rules we made, FSMA provisions specify certain terms. In particular, the FOS must determine a complaint by referring to what is fair and reasonable in all the circumstances of the case. That is a judgement for the FOS, but our rules clarify that in reaching a judgement in a particular case, the FOS should take into account relevant regulations, regulators' rules and guidance and standards.

13. Some observers have asked for more clarification on how arrangements for the FOS relate to our TCF work and whether it would be for the FSA or the FOS to determine whether a firm has acted fairly.
14. As we have noted in relation to UTCCR, our TCF work focuses mostly on the culture of a firm and its systems and controls for delivering fair treatment for customers in general. The FOS applies a different test, and is concerned specifically with the question of resolving whether an individual consumer has been treated fairly in the context of a specific transaction. The FOS has been represented on the TCF Consultative Group.
15. An adverse finding by the FOS in a particular case may not be definitive proof of a breach of an FSA rule. It could reflect an isolated incident, error or oversight by the firm, rather than a wider TCF failing. In a non-zero failure regime, mistakes can be made and the FOS is there to ensure that such mistakes are corrected and appropriate remedies are given.

Other legislation

16. There is other legislation – often agreed at the European level – which affects how regulated firms should deal with their customers in certain situations or how we enforce certain standards.
17. The Distance Marketing Directive (DMD) sets out various requirements concerning distance selling of financial services and products, principally information disclosure and cooling-off requirements. The requirements for authorised firms have been implemented through FSA rules.
18. The implementation of the Markets in Financial Instruments Directive (MiFID) will have a substantial impact on our conduct of business rules for investment services. MiFID will affect how far we can take our principle-based approach to TCF in certain areas, as we will need to make some detailed rules to implement some of its detailed requirements. There are, however, some similarities between our approach and what MiFID requires. For example, MiFID requires firms to:
 - act honestly, fairly and professionally in line with the best interests of their clients when providing investment services to them; and
 - address fair, clear and not misleading information (including marketing communications) to clients.
19. MiFID provides a framework for the new conduct of business requirements which will be supplemented by more detailed rules. Those rules, which are still being discussed at the European level, are expected to be agreed in the first quarter of 2006. Only then will we have a precise picture of how MiFID will impact on our principle-based approach. We will consult on our proposed rules for implementing those requirements in due course.

20. The Unfair Commercial Practices Directive (UCPD) will prohibit unfair practices by businesses in their dealings with consumers. The UCPD adopts a principle-based approach, which fits neatly with our approach to TCF. For financial services firms, its aim is to keep the harmonisation measures across Member States to a minimum. This means that that we can impose requirements which are more prescriptive or restrictive than those contained in the UCPD. We do not envisage any major changes to the Handbook, although, in the area of deposit-taking, the UCPD will impose some new conduct of business obligations. The UCPD will also have some implications for the Banking Code and its relationship to FSA rules for a range of consumer activities. We will have to incorporate any new requirements into the Handbook by June 2007, but firms will not have to comply with those requirements until December 2007.
21. The European Commission is currently reviewing several consumer protection directives, including the Unfair Contract Terms Directive, to identify problems in implementing and applying EC consumer law. The review will feed into the development of a Common Frame of Reference (CFR) which will provide clear definitions of legal terms, fundamental principles and coherent model rules of contract law. The CFR will be used as a 'toolbox' for the Commission when presenting proposals to improve the quality and coherence of current and future rules. The outcome of the Commission's review (expected in 2007) and the development of the CFR (expected in 2009) may also have an impact on how we apply our principle-based approach to TCF in the future.



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