Financial Services Authority

Treating Customers Fairly initiative: progress report

May 2007

Key messages

- Our latest FSA assessment of progress with the Treating Customers Fairly (TCF) initiative shows that an encouraging number of firms successfully met the March 2007 deadline, by which time they had to be implementing necessary change in a substantial part of their business.
- We believe this shows that senior management in these firms remain committed to making progress with TCF and are successfully rising to the challenge presented by this important example of a principles-based approach.
- However, given that TCF has been a priority for some time, we are disappointed that a sizeable number of firms failed to meet our March deadline.
- We can place limited reliance on senior management in these firms, and will intensify our supervisory focus accordingly (including through use of enforcement where warranted).
- TCF will continue to be a major focus in our work with small firms and we provide a range of tools to help small firms tackle this important issue.
- All firms need to continue to focus on TCF. The March deadline has created helpful momentum so we are setting further deadlines in 2008. And we will be increasing the amount of our own FSA resources devoted to supporting and testing firms in meeting these deadlines.
- In future, where firms can demonstrate their own performance (and it is good), there will be less scrutiny and therefore a regulatory dividend.

Treating Customers Fairly initiative: progress report

Background

1. The Treating Customers Fairly initiative (TCF) is an important example of the principles-based approach to regulation in practice. As with the FSA's principles-based approach generally, our focus is on placing responsibility on firms' senior management to deliver fair outcomes for consumers and offering firms the flexibility to deliver these outcomes in the way which best suits their business.

Firms should be focused on delivering the six TCF consumer outcomes:

i. Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture

ii. Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly

iii. Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale

iv. Where consumers receive advice, the advice is suitable and takes account of their circumstances

v. Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect

vi. Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint

2. Many firms have already invested substantially in changing the way they conduct their business to ensure that they are meeting the requirements in FSA Principle 6.[1] We have worked with the industry on TCF since 2004, and have encouraged firms to use a

1 Principle 6 states: '*a firm must pay due regard to the interests of its customers and treat them fairly*'. Other Principles are also relevant when taking a rounded view of what fair treatment might mean, including Principles 1, 2, 3, 7, 8 and 9.

structured approach to reviewing their business and introducing change – through four phases – 'aware', 'strategy and planning', 'implementing' and 'embedding'[2].

3. In July 2006 we set a deadline for all firms to be at least implementing TCF in a substantial part of their business by the end of March 2007. The aim was to stimulate action in firms that were slow to appreciate the significance of TCF and to maintain momentum in those firms that were moving ahead with their TCF initiatives. This note sets out the results of our work to measure firms' progress against this deadline.

Measuring progress with 'implementing' TCF

4. We have assessed performance against the deadline by looking at the progress firms have made with their TCF initiatives rather than whether they are delivering fair outcomes in all cases for their customers. In some cases, a firm may have failed to meet the deadline, but this does not automatically mean that the firm is not treating its customers fairly. Equally, a firm that has met the deadline may still have a substantial programme of work to complete.

5. We now expect firms that have missed the deadline to engage and make rapid progress with their work on TCF.

6. For the vast majority of firms, we believe further progress is needed to reach the embedding phase and ensure the consistent delivery of fair consumer outcomes. This is, and will continue to be, a significant challenge for most firms, and requires sustained focus from senior management.

Progress against the March deadline

7. The following number of firms have successfully met the March 2007 deadline:

- 37 major retail groups (93%)[3,4];
- 379 (of a sample of 436) medium-sized firms (87%)[5];
- 49 (of a sample of 66) wholesale firms where TCF is materially relevant (74%); and
- 273 (of a sample of 659) directly authorised small firms (41%)[6].

8. The March deadline has helped to focus firms' efforts on TCF and generated momentum within the industry as a whole. These results also show that many firms – particularly larger and medium-sized firms – have made good progress with their TCF work. Senior management in these firms remain committed to making progress with TCF and to making the principles-based approach work.

2 We defined implementing as allocating resources and responsibility; developing on plans and processes; and creating capability. For full details of the stages of TCF see our paper 'Treating customers fairly – towards fair outcomes for consumers', July 2006, p19.

3 Firms regulated by our Major Retail Groups division

4 40 assessments completed, some were based on groups, others on business units within groups.

5 Firms regulated by our Retail Firms division

6 Firms regulated by our Small Firms division

9. The results also show improvements – particularly among medium-sized firms – since we reported firms' own assessment of progress in July 2006.[7] And we know from our assessment of progress that a small number of firms have now progressed beyond implementing.

10. However, on the basis of our assessment, a sizeable proportion of firms failed to demonstrate that they are implementing TCF. This means that senior management in these firms have failed to create and put into action a plan to meet an existing regulatory requirement. They have failed to take sufficiently seriously the need to address TCF risks in their business.

11. Some sectors have performed particularly poorly. Only 22% of small mortgage advisers and 45% of small general insurance advisers met the deadline. Only 52% of small directly authorised financial advisers met our deadline.[8] It is worth noting that we carried out our assessment of small firms in December 2006 and January 2007. We therefore expect that some small firms will have made further progress between January and March and will test this as part of our follow-up work.

Methodology used to assess progress

12. This is the first time we have carried out an industry-wide measurement of progress against the phases of TCF. Previous assessments have been based on firms' self reporting.

13. For larger (relationship managed) firms engaged in retail markets we looked at each firm individually. We considered all relevant information available to us at that time, including information from usual supervisory contact (e.g. ARROW risk assessment or thematic visits). And, in some cases, we included the results of specific visits we made to look at particular TCF-related issues.

14. For wholesale firms we assessed a representative sample of firms where their activities include a business which deals directly with retail customers, where they contribute to the origination of products which are distributed by other firms to retail customers, or where they distribute wholesale to firms that distribute direct to retail customers.

15. For small firms[9], we conducted a major, statistically valid telephone survey of 659 firms to assess progress against the phases of TCF. We supported this with verification visits to 5% of the firms surveyed to ensure that the results were correct. We concentrated the sample around three major sectors where the primary business is investment, mortgage or general insurance business. We designed the survey to assess what firms were doing on a range of important TCF issues such as management behaviours and how these impact for example, on advice and complaints. We did not focus our survey on whether a firm understood TCF 'processes' or TCF terminology as used in our publications on the subject.

7 See 'Treating customers fairly – towards fair outcomes for consumers', July 2006, p 21-22. This included the results of a self-assessment survey by firms which reported that 80% of major retail groups and 51% of a sample of medium-sized firms believed that they were at least implementing TCF.

8 Generally the sector categories we have considered are those we use in our risk assessment framework. We have also, however, looked to see whether the percentage missing the deadline differs between small directly authorised firms and networks (whose members are small firms). For financial advice networks (some of which also conduct mortgage and general insurance business) the percentage that met the deadline is 63% which we do not consider to be significantly different from the 52% for small directly authorised financial advisers.

9 Directly authorised firms regulated by our Small Firms division.

Action against firms who have not met the deadline

16. Where firms have missed the deadline, we believe that this points to a failure by, or lack of commitment from, senior management. This failure means that we can only place limited reliance on these firms' senior management to deliver the right outcomes for their customers.

17. We will therefore increase the focus and intensity of our supervisory approach for these firms. We will take a targeted approach that will depend on the reasons why a firm failed to meet the deadline, and the scale of the task they face in filling the gap. Our follow-up work is likely to have significant cost implications for these firms.

18. For relationship-managed firms we will, for example, use tools such as requiring skilled persons reports, imposing demanding risk mitigation plans with challenging deadlines, and rigorously reviewing and monitoring progress.

19. The results are particularly disappointing for small firms. However, we were encouraged that of those firms that failed to meet the deadline, many were making slow progress rather than failing to engage with TCF at all. We also expect that because of their size and structure, the scale of the challenge is smaller. So with increased focus, small firms should now be able to make quick progress through the TCF stages.

20. To support this, we are taking immediate follow-up action with small firms. In line with our risk-based approach, our primary focus is to target those firms who pose the greatest risk to our objectives. We will visit every firm which has failed to engage with TCF and we will conclude these visits by the end of June.

21. We have written to those small firms in the sample which have engaged with TCF but have failed to meet the deadline and where progress was slow or of poor quality. We have advised them of the main weaknesses found in their sector to help them assess the risks present in their own firm. We will also visit 10% of this part of our sample and where we find that inadequate progress has been made we will take appropriate firm-specific action.

22. If now, or as a part of future supervisory action, we become aware of significant actual or potential consumer detriment in a firm of any size that failed to meet the deadline, we expect to make a referral to enforcement. Given the importance we attach to senior management this may include considering referrals on the grounds of senior management failings. We will also consider the case for immediate action in the form of varying the firm's permission so that it cannot, for example, continue to conduct regulated business until it resolves the problems.

Priorities and next steps

23. Where firms have met the deadline, we will continue to look in the first instance to their senior management to progress work to embed TCF. They need to demonstrate to themselves and to us how they are treating their customers and whether they are delivering fair outcomes. This requires a firm to collect information which is proportionate to its size and nature. And senior management will need to use this information to identify and tackle any issues and to apply what works well more widely.

24. Some firms are progressing with the development and use of management information for TCF. But where firms do not have this evidence and/or are not actively using it, continued poor results from much of our industry-wide thematic work means that we cannot assume that all is well. Instead, we will need to ask searching questions to understand what might be going wrong and why. This will include a greater amount of detailed testing at the consumer interface, such as interviews with front-line staff and file reviews.

25. In addition, to assist us in testing firms that are unable to evidence that fair outcomes are being delivered, we are currently developing and piloting a framework through which potential TCF risk areas in a firm's culture can be identified. This framework has been developed not only from our experiences in TCF, but also from our other work on specific themes, which provide powerful information on the factors, or 'drivers', within an organisation which can lead to fair or unfair outcomes. We anticipate that using this framework will help us (and the senior management in firms) to understand some of the root causes of unfair outcomes, and therefore reduce the risk that customers are treated unfairly.

26. So far, we have identified the key cultural 'drivers' to be: leadership; strategy; decision making; controls; internal communication; recruitment, training and competence; and reward. We believe these drivers are likely to have a significant influence on behaviours of management and staff, and therefore on consumer outcomes. For small firms, not all these drivers will be relevant, but we have identified the key management behaviours in a small firm which can have an impact on whether a customer is treated fairly.

27. Where relevant, we intend to integrate work using the culture framework and management behaviours into ARROW risk assessments and thematic work, and we will also conduct bespoke visits outside the usual ARROW cycle. The elements of the culture framework and the management behaviours for small firms are outlined in Annex 1. We will publish more details, as well as examples of good and poor practice, in July.

TCF a continuing priority for small firms

28. For small firms we already provide a range of TCF online tools and opportunities for firms to talk directly to FSA staff on TCF.

Existing tools available to help small retail firms make progress on TCF:

We offer materials on principles-based regulation and TCF on our small firms website[10]

- Our small firms website is already a popular resource with over 50,000 visits per month on average.
- We have updated the existing information on the TCF section of the website to include key findings from the TCF telephone surveys and to include sector specific examples of good and poor practice.
- The site also includes a TCF self assessment tool which many firms have told us that they have found helpful.
- Later this year, we will launch sector specific self assessment tools to help firms move towards TCF becoming business as usual. This work will also cover management behaviours which drive the culture of a small firm.

We also offer opportunities for firms to engage directly with members of the FSA on TCF.

- The Firms Contact Centre handles day-to-day queries on general regulatory issues, including TCF.
- In the last year over 2,500 firms have attended either our free roadshows or taken the opportunity to have a face-to-face meeting with one of our supervisors at a 'surgery'. A further 1,800 have attended industry training courses for small firms.
- This month we are rolling out affordable new regional TCF workshops for small firms which will focus on the TCF survey findings and how firms can continue to make progress with their TCF work. These will be available to meet demand and firms can book their place using our new online booking system.[11]
- TCF will continue to be a key focus at our free roadshows where firms have the opportunity to hear directly from us and ask questions.[12]

29. TCF will continue to be central to our project work with small retail firms – its core purpose is to test whether firms are delivering fair outcomes for consumers in key areas such as clear disclosure documents, suitable advice and fair complaints handling. In future, small firms can expect even more focus on TCF in their dealings with us. When feeding back the results of our work to individual firms and the industry we will focus on explaining how the findings relate to TCF as a whole. And we will continue to explore how we can reach and interact with small firms on the subject of TCF.

10 See www.fsa.gov.uk/Pages/Doing/small_firms/index.shtml

11 See www.fsa.gov.uk/Pages/Doing/Events/workshops/index.shtml

12 See www.fsa.gov.uk/Pages/Doing/Events/events/supervisor.shtml

Further deadlines

30. Clearly, firms must already comply with Principle 6 ('A firm must pay due regard to the interests of its customers and treat them fairly') and other FSA Principles and rules. This means that enforcement or other regulatory action may be appropriate now if we find firms failing to treat their customers fairly.

31. We believe it is essential that senior management drive real change as rapidly as possible. The March deadline helped to focus firms' efforts on TCF and generated momentum within the industry as a whole. We now need to increase this momentum so we have decided to set further deadlines.

32. **By the end of December 2008 all firms are expected to be able to demonstrate to themselves and to us that they are consistently treating their customers fairly.** One method of doing this will be to show that they are delivering, in particular, the six TCF consumer outcomes we have identified (see p2).

33. Firms need to have information to enable them to comply with their regulatory obligations[13]. Demonstrating delivery of the TCF outcomes will require using management information proportionate to the size and complexity of the business. We are setting an **interim deadline** to encourage firms to focus on and make progress in this area. Therefore **by the end of March 2008 firms are expected to have appropriate management information or measures in place to test whether they are treating their customers fairly.**

34. Many firms have found identifying, collecting, and using management information for TCF challenging. We have already provided supporting material on this subject[14]. The key is that firms use information proportionate to the size of their business to demonstrate that they are treating their customers fairly. For small firms, this information may be relatively simple. To support firms in meeting the March 2008 deadline for management information we will work more with the industry to help develop and share good practice, including in our forthcoming publications on the findings of our work on culture (in July), and on measuring industry-wide progress against the TCF outcomes (in October).

35. For our part, the assessment of TCF progress will continue to be central to our retail strategy, and TCF is an overarching priority for all our retail thematic work. We intend to build on this approach in the next phase of the initiative, including monitoring progress against the new deadlines.

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13 FSA Handbook, SYSC 3.1.11
(1) A firm's arrangements should be such as to furnish its governing body with the information it needs to play its part in identifying, measuring, managing and controlling risks of regulatory concern. Three factors will be the relevance, reliability and timeliness of that information.
(2) Risks of regulatory concern are those risks which relate to the fair treatment of the firm's customers, to the protection of consumers, to confidence in the financial system, and to the use of that system in connection with financial crime.
SYSC 3.2.12
It is the responsibility of the firm to decide what information is required, when, and for whom, so that it can organise and control its activities and can comply with its regulatory obligations. The detail and extent of information required will depend on the nature, scale and complexity of the business.

14 TCF Management Information cluster report, July 2006
http://www.fsa.gov.uk/pages/Doing/Regulated/tcf/pdf/management_info.pdf

Impact of this new strategy

36. This strategy does not alter the fundamental message to firms since 2004 – they need to review their business, and consider and implement any changes needed in order to comply with the FSA Principles.

37. We encourage those firms which have met the March deadline to keep up the momentum and to progress towards embedding TCF.

38. We can only place limited reliance on senior management in firms that have failed to meet the March deadline and they can expect costs to be imposed as a result.

39. In all firms, we will challenge senior management to produce evidence that they are treating their customers fairly and delivering the desired consumer outcomes. As well as collecting management information, we expect senior management to use the information effectively.

40. If we are satisfied that a firm has robust systems and controls and the senior management are reviewing and using reliable management information which demonstrates that they are treating their customers fairly, we will significantly reduce the level of testing we carry out on the firm's culture and at the consumer interface.

Annex 1 – Our cultural framework and initial findings

We are developing an approach which examines TCF in firms' cultures. In our publication in July 2006 we set out consumer outcome one – 'consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture'.

We are carrying out pilot work, including a visit programme, to identify the key cultural drivers within organisations that we believe are likely to have a significant influence on behaviours of management and staff and therefore on consumer outcomes.

The table below set out the drivers, and the associated positive indicators and negative (contra) indicators of good behaviour, which we have identified from our work so far:

Key cultural drivers and high level indicators and contra indicators

Indicators	Key driver	Contra-indicators
Fair treatment of customers is central to the behaviour and values of all managers, and they apply controls and monitoring to ensure that the desired outcomes are delivered by their staff	Leadership	Leaders (at any level) cannot articulate what fair treatment of customers means for them and their staff and cannot demonstrate that their staff understand what TCF means
The firm has a clear vision which supports TCF. TCF is reflected within the formulation and implementation of strategic decisions (including change management programmes). The firm's risk appetite reflects consumer considerations.	Strategy	The firm's vision is unclear/blurred or contradicts TCF. The Board does not consider TCF when making key decisions about future direction
Decision making reflects the spirit of TCF. Firm uses staff, consumer and other external feedback where appropriate, with timely action. The interests of customers are properly balanced against those of shareholders (and other customer groups)	Decision making	Minimal evidence that decisions reflect any consideration of the impact on consumers. Firm is slow or unwilling to react to consumer/staff feedback. Conflicts between the interests of shareholders and consumers are consistently resolved in favour of shareholders
Controls, including management information, are integral to the firm's risk framework, protect the consumer, identify weaknesses and are used by the firm to improve its treatment of customers	Controls	The firm cannot evidence consumer protection through its controls, has minimal management information and does not use this information to improve its treatment of customers
The firm has a clear communication strategy, from the top to bottom, delivered by key personnel with employees tested on their understanding and quality of implementation	Internal communication	Little evidence of regular and timely communication across the firm and little demonstration that the message is understood and implemented by staff
Positive behaviours and attitudes to TCF are a key criteria in the selection of staff. Effective training and the maintenance of staff behaviours and values is core to the business	Recruitment, training and competence	The firm has a basic/inadequate T & C scheme, applied to staff undertaking regulated activities only, with little focus on TCF and has a lack of appreciation of how staff competence has an impact on the consumer
The firm's reward (including incentive scheme) and performance management framework throughout the business is transparent, recognises quality and supports the achievement of the six consumer outcomes	Reward	The firm's reward and performance management framework concentrates on sales and profit without consideration of quality and achievement of outcomes i.e. the framework drives poor TCF outcomes

We have also developed a management behaviour framework suitable for small firms:

Management Behaviour framework for small firms

Indicators	Key driver	Contra-indicators
Fair treatment of customers is central to the behaviour and values of the firm, and management are able to articulate what TCF means for their firm	Leadership	The management cannot articulate what fair treatment of customers means to them or the firm
When management make key business decisions, the firm will always assess the impact on TCF	Business planning	When management make decisions they do not apply TCF principles
Through monitoring of the day to day activity, management ensure that TCF principles are being applied consistently	Controls	Management do not know if their staff are treating customers fairly
The firm communicates clear messages to staff and can demonstrate that they have been understood	Internal communication	Management do not communicate effectively with each other or their staff
Positive behaviours and attitudes to TCF are a key criteria in the selection of staff. Effective training and the maintenance of staff behaviours can be observed	Recruitment, training and competence	The firm has a basic/inadequate T & C scheme, applied to staff undertaking regulated activities only, with little focus on TCF and has a lack of appreciation of how staff competence has an impact on the consumer
Management operate a reward structure and performance management framework that is transparent and recognises quality	Reward	Firm concentrates on sales made with bonus payments and promotion based on quantity not quality

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