Grant Thornton

Consumer Duty - the Annual Board Report

How to meet the FCA's expectations

2024

Introduction

When the FCA introduced the Consumer Duty rules in July 2023, it recognised that real change would only come about if the Boards of regulated firms fully bought into the need for change. While the new rules and a new Principle 12 introduced by the regulator formed part of the solution, the FCA realised that more was needed for firms to consistently meet its higher expectations.

Therefore, recognising the critical role Boards play in driving the "tone from the top" and shaping their firms' cultures, and building on the principles of individual accountability that already underpin the Senior Managers and Certification Regime (SM&CR), the FCA introduced a degree of prescription squarely focused on Board members.

One aspect of this is the need for firms to appoint a Consumer Duty champion at Board (or equivalent governing body) level, who is required to work alongside the Chair and CEO to ensure that Consumer Duty gets sufficient time attention in Board discussions.

Another is to focus the Boards' attention by requiring them to review – and, crucially, formally approve –an annual report on the extent to which their firms are meeting the new requirements to deliver good outcomes for their customers.

Whether these requirements prove to be a regulatory masterstroke, delivering not only good individual customer outcomes but the sustainable, macro-level, culture changes needed to increase confidence in the UK financial services sector more generally, time will tell. Cultural change is unlikely to happen overnight.

But there is a real sense of urgency on behalf of the FCA to implement some of the drivers and facilitators of that change as quickly as possible, with new regulatory deadlines fast approaching. Some firms – those with closed books - will already be working towards the 31 July 2024 deadline for implementing Consumer Duty for legacy products and services. However, all firms caught by the Consumer Duty should already be working towards the same deadline for producing the annual Board assessment, and there is no time to waste.

The FCA outlined its direction on this matter in November 2023, when Nisha Arora, Director of Cross Cutting Policy and Strategy, warned against complacency and gave a call to action: "This will take time to do well, so don't delay!" And just in case positive encouragement fails to focus minds, she reminded firms that the FCA will be asking to see the annual reports and underlying supporting data and MI as part of its ongoing supervisory activities.

"Ignore at your peril" is clearly the underlying message and, as per usual, if the supervisory 'stick' doesn't produce the required results, there is always an even bigger enforcement 'club' for regulators to wield if firms fail to comply.

So how to comply? What should firms be doing now to ensure they meet the new deadline for producing the annual Board report and how best can they demonstrate that it meets both the word and the spirit of the new requirements? We set out in the following pages our observations and practical guidance on what firms should be doing now to ensure they meet the new standards.

It is critical that firms invest the time and resources to get this right. This is clearly a key focus area for the FCA, as seen by the Consumer Duty being heavily referenced within the FCA's 'Commitment 2: Putting consumers' needs first' within the 2024-2025 Business Plan.

A reminder of the annual report requirements

The FCA has set out the requirements for the annual Board report in Policy Statement PS22/9 and, more fully, in its Finalised Guidance FG22/5, both dated July 2022. These are, in summary:

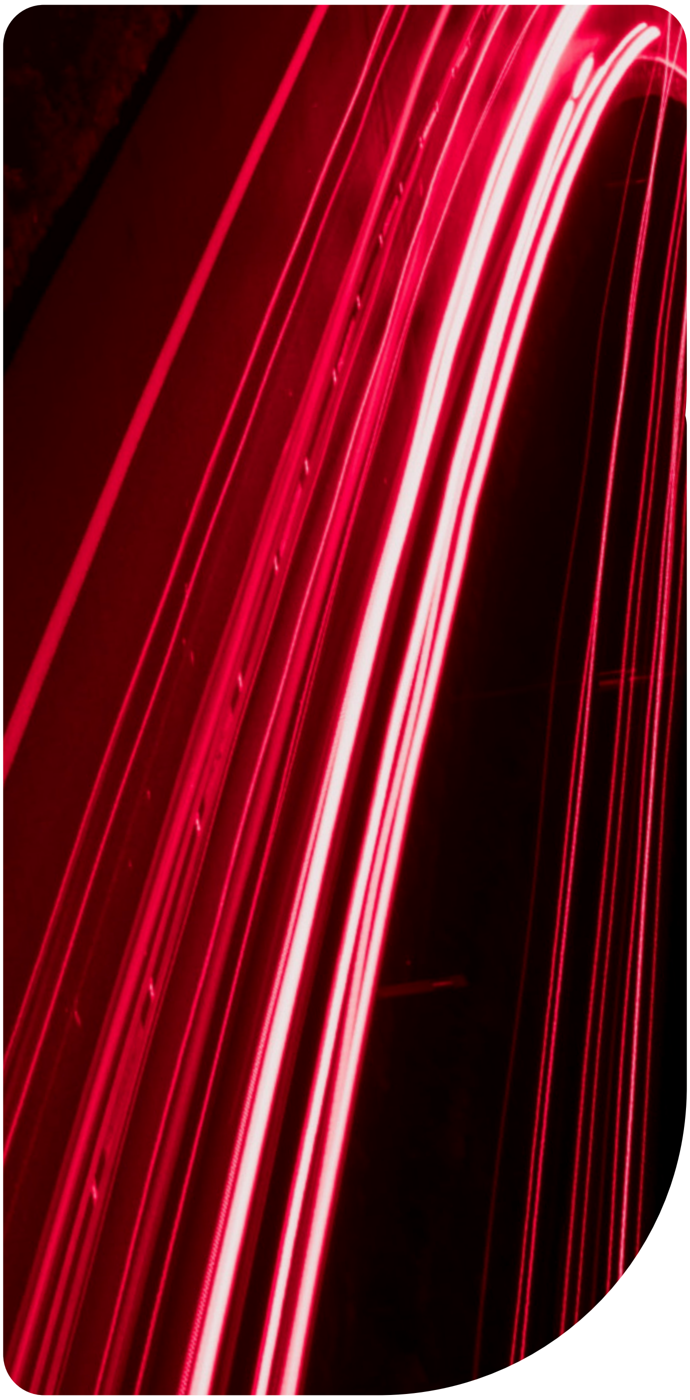
The Board (or equivalent governing body) to review and approve an assessment of whether the firm is delivering good Consumer Duty outcomes, and to do so at least annually.

This should include:

- the results of the monitoring that the firm has undertaken to assess whether products and services are delivering expected outcomes in line with the Duty
- any evidence of poor outcomes, including whether any group of customers is receiving worse outcomes compared to another group, and an evaluation of the impact and the root cause
- an overview of the actions taken to address any risks or issues
- how the firm's future business strategy is consistent with acting to deliver good outcomes under the Duty

Before signing off the assessment, the Board (or equivalent governing body) should agree the action required to address any identified risks, or any action required to address poor outcomes experienced by customers and agree whether any changes to the firm's future business strategy are required.

To be sure of meeting the first annual reporting deadline of 31 July 2024, the Board will have to have reviewed and approved the assessment by that date, including agreeing any actions to address poor outcomes and any proposed changes to business strategy in light of the results. This means that the Board should be seeing at least a draft of the report well before that date, so that any changes can be agreed early and formalised by the deadline.



Report planning

It is vital that the annual report is carefully planned, with well-defined roles and responsibilities, key stakeholder involvement and clear milestones to work towards.

Allocate roles and responsibilities – those responsible for preparing, populating and reviewing the report should be decided early. We would expect the first line to take the lead on this, with appropriate second and third-line input and review. The Board champion should be involved to help shape the report to meet the Board's needs.

Develop a project plan – working back from the deadline, firms should develop formal project plans that identify the critical path, account for key dependencies between tasks and have clear milestones. They should also take account of the scheduling of Board and other relevant committee meetings to ensure that materials are ready for review when needed. Rigorous project management discipline needs to be applied to ensure these milestones are met.

Engage key stakeholders – effective communication will be vital to ensure all stakeholders are fully aligned on the objectives, are aware of their roles and take full ownership of the actions allocated to them. All parties will need to be clear on their deliverables and the timing of those deliverable if they are to be able to work seamlessly together.

Involve second and third lines of defence – this will be vital for two key reasons:

1. Under PRIN 2A.8.1R firms must formally ensure that retail customer outcomes are a central focus of both the firm's risk control arrangements and its internal audit function. The results of ongoing assurance activities should already be part of regular reporting to the Board and will also need to be summarised in the annual report. The second and third lines should ensure that the summary of any QA, monitoring or audit results is reflective of the regular outcome reporting and is presented in a fair and balanced way.
2. The second and third lines are required to provide a stand-back, independent assessment and, ultimately, whether it is likely to provide the Board (and the FCA) with confidence that the firm is meeting its Consumer Duty expectations or has a robust plan to address any shortfalls.

Identify the data requirements – firms should already be measuring customer outcomes using both qualitative and quantitative metrics that are already operational and have been agreed by senior management - calibrated and mapped to the firm's risk appetite. Identifying the key data feeds and how they will be aggregated and presented in a digestible way for the Board will be key, as will ensuring that the relevant teams are on point to extract and provide the data when needed. If there are gaps in outcomes testing, these should be prioritised and addressed immediately so that there are no unwelcome surprises as the reporting deadline approaches.

Test the 'proof of concept' – Boards should ideally see the report template and iterated drafts of the populated template before it is formally presented for approval. The FCA will expect the Board to take a proactive role in shaping the report, given that they will be the ones approving it and ultimately "attesting to" the status of Consumer Duty compliance in their firms. This will also enable actions to be agreed to close any gaps prior to presentation of the report for signing. The role of the Board champion will be crucial here to facilitate two-way communication between those preparing the report and those ultimately approving it.

Report content

Recognising that a “one size fits all” approach is unlikely to work for Consumer Duty, which covers a very broad range of firms and sectors, the FCA has not been prescriptive as to the format of the annual report.

Instead, it has put the onus on firms to decide what works best for them, depending on the scale and nature of their business, their role in the distribution chain and their impact on retail customers. This gives firms some leeway to take a proportionate approach, but the end objective remains the same for all firms, i.e. to set out the results of the firm’s monitoring of customer outcomes and evidence a longer-term cultural commitment to change where those outcomes currently fall short of the expected standards.

So, what should be in the annual report? We have set out some helpful pointers below:

Scope – firstly, the FCA has confirmed that for firms which have both existing and closed products, the first annual report needs to only refer to the former.

Coverage – the report should cover all four Consumer Duty outcomes, but this is unlikely to be enough. Firms should also give due weight to how they comply with the three cross cutting rules (acting in good faith; avoiding foreseeable harm and supporting retail customers to achieve their objectives) as well as the new overarching Principle 12.

Granularity – limiting the report to an analysis of customer outcomes “in the round” is unlikely to be sufficient to meet the FCA’s expectations. Firms should recognise that customer outcomes will be scenario-specific and might not be the same for all groups of customers. There should be a specific focus on any groups of customers that might not be receiving good outcomes and how this is being addressed.

Vulnerable customers – an obvious candidate for specific attention in the report is what firms are doing to support vulnerable individuals. This is high on the FCA’s wider agenda and, not surprisingly, was a key focus of PS22/9.

Comprehensiveness – It’s important not to underestimate how much work is required. The report needs to cover, at least:

- the results of the monitoring that the firm has undertaken to assess whether products and services are delivering expected outcomes in line with the Duty
- any evidence of poor outcomes, including whether any group of customers is receiving worse outcomes compared to another group, and an evaluation of the impact and the root cause
- an overview of the actions taken to address any risks or issues
- how the firm’s future business strategy is consistent with acting to deliver good outcomes under the Duty

Good practice would also be to include the following:

- evidence of the Board having reviewed and approved annual testing and monitoring plans for the first, second and third lines and the progress made against those plans
- a summary of key operational and strategic decisions made through governance forums charged with overseeing compliance with the Duty
- a log of loss events and incidences of customer harm identified during the year, with details of redress and the status of any remediation programmes or activities.

- **Focus on outcomes, not inputs** – firms will rightly want to take credit for all the hard work they have done to train staff and improve internal processes, systems and controls as part of their Consumer Duty implementation. But, while important, focussing on these 'inputs' risks missing the point. What counts is whether customers are consistently getting the right outcomes, and this does not necessarily flow automatically from enhancing processes and training. The annual report, and the MI it contains, should therefore be focused primarily on outcome-focused measures, i.e. not what should happen as a result of change, but what is actually happening in practice. For the same reason, firms should not take comfort in the volume of data they include in the report – the key is measuring outcomes against pre-agreed and well-defined criteria.

- **An honest appraisal** – the primary objective of the report is to provide an honest appraisal of the firm's progress with Consumer Duty rather than, say, a formal attestation that the firm is 100% compliant in every respect. Understandably, the regulator will want firms to not only have implemented the Consumer Duty for new and existing products, but to have made some progress since July 2023 in embedding any changes. But cultural change takes time, and the FCA will not expect everything to be perfect. Dashboards that show all metrics as green could attract as much regulatory attention as those liberally showing red metrics. The key here will be to avoid complacency and show that the Board has a clear action plan to address any amber or red areas that signify customer outcomes are not yet fully meeting expectations.

- **Calibration for consistency** – it is important that the annual report is a "build" on the regular monthly or quarterly dashboard reporting that precedes it and that any conclusions or outcome RAG ratings it contains flow logically from what has previously been reported to the Board. An annual report that is presented in isolation and tells a different story to the more regular reporting is likely to arouse suspicion.

- **Presentation** – in line with good practice for Board reporting, the annual report should set out its purpose and clearly signpost the need for formal Board approval. It should start with an executive summary and include a good balance of quantitative data and qualitative explanatory commentary. The key measures the firm has relied upon to draw its conclusions should be front and centre, but detailed metrics should be confined to an appendix, so that they don't obscure the key messages. Proposed actions will need to be included to address any weaknesses, with owners and realistic deadlines.

Board review and follow up

Naturally, the primary focus for the annual report will be on the end goal of obtaining Board approval prior to the deadline. But this is about much more than simply producing a deliverable – it's as much about the journey and the iterative process needed to ensure that what is presented for final approval is both fit for purpose and provides a clear basis for follow-up action.

Senior management engagement and ownership will be vital, as will the need for robust governance:

Early Board engagement – the Board should not be seeing the report for the first time at the approval stage. This will be too late. The Board needs to be involved in the top-down shaping of the report, so that it meets their needs, rather than being a passive recipient. The Board champion will have a key role to play here, acting as a representative of the Board and a conduit for agreeing the format, content and, crucially, the actions with the business along the way. Getting 'buy-in' from senior management at each stage will mean that the report can be signed-off without qualification or delay, and before the regulatory deadline.

Action plan – the Board must have agreed to any forward-looking actions to address poor outcomes, and these should be part of a well thought through and properly prioritised action plan with allocated owners and agreed timeframes. The 'SMART' goal setting methodology is a useful reference point when setting actions:

Specific – have clarity on the target outcomes and how to achieve them. Consider the overall outcomes for the full end to end customer journey as well as at key touchpoints along that journey.

Measurable – determine the objective criteria for success and how this will be measured in practice; align metrics to target outcomes and risk appetite.

Achievable – focus on matters within the firm's control, rather than external factors outside the firm's control, but be realistic about how those external factors, e.g. the macro-economic outlook, might impact adversely; build in contingency if possible.

Relevant – focus on outcomes, not inputs. Recognise that customer satisfaction and good outcomes are not necessarily the same thing and target the latter.

Time-bound – set clear timeframes for completion; there should be pace and a sense of urgency, but do not underestimate how long things might take and set target completion dates accordingly.

Strategy – firms should be open-minded and flexible. The FCA will expect Boards to change strategy if the current business model is not conducive to good customer outcomes. It is quite possible that some practices, while currently permitted, cannot be reconciled with the objective of good customer outcomes and may need to change.

Governance – in line with good governance, ensure sufficient time is allocated on Board agendas for discussion of the report, that discussions, challenge and approvals are clearly accounted for and that actions are fully documented, allocated owners and diligently tracked through to completion.

How we can help

We have over 50 regulatory conduct specialists who have been immersed in Consumer Duty since it was first proposed by the FCA, and who have already provided extensive support to a wide range of clients across the financial services industry with their Consumer Duty compliance. Our clients range from small, newly authorised firms to FTSE 100 institutions, and we tailor each assignment to the specific clients' needs.

Our work has covered all aspects of firms' preparations, including impact and gap analyses, project plan reviews, assurance and internal audit, technical and regulatory advice, readiness assessments, benchmarking, governance and culture reviews, MI design, Board training, programme management and resource augmentation. We offer deep insights into responding to the Consumer Duty challenge in a positive and pragmatic way.

We can help ensure that you are in the best possible position to demonstrate that you are taking Consumer Duty seriously and meeting the FCA's expectations. We can provide practical advice, support and resources to ensure you meet the July 2024 annual reporting and closed book implementation deadlines on time.

Please contact us to discuss your specific requirements. We are here to help.

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