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A Comparative Analysis of US Consumer Protection Regulations and the FCA's Consumer Duty

Compliance expert and former Head of Compliance, Sylvia Yarbough, shares insights from the heart of the compliance team. Drawing on over 25 years of experience in the regulatory industry for financial services, Sylvia, compares UK and US consumer protection regulations.

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I recently reviewed the Financial Conduct Authority's (FCA) Consumer Duty regime that will become effective on 31 July 2023 for new and existing consumer products or services (31 July 2024 for closed products). It represents a series of principle-based standards, focused on increasing consumer protection and promoting fair practices in the financial services market within the United Kingdom (UK). The expectation is that firms will use reasonable and prudent approaches to ensure fair outcomes for consumers throughout the lifecycle of consumer interaction from product strategy to customer service.

I will admit I found the concepts intriguing the more I compared some of the key callouts to United States (US) Consumer Protection Laws. I identified some pros and cons to the approach and wanted to share my thoughts.

As outlined in the Duty:

- A Consumer Principle reflects the overall standard of behavior we want from firms and is defined further by the other elements of the Consumer Duty.
- The 'cross-cutting rules':
  - develop our expectations for behavior through three overarching requirements that explain how firms should act to deliver good outcomes, which apply across all areas of firm conduct, and
  - form and help firms interpret the four outcomes.
- The 'four outcomes' are a suite of rules and guidance setting more detailed expectations for firm conduct in four areas that represent key elements of the firm-consumer relationship:
  - the governance of products and services,
  - price and value,
  - consumer understanding, and
  - consumer support.

First, as a former US-based compliance professional, I have always found it amazing how regulators outside the US can publish rules that are so broadly written and somewhat subjective and expect financial services firms to "do the right thing." Even more amazing, the extensive issues that we have in the US with regulatory violations do not seem to exist in other countries.

I often question that international countries' regulations are not scripted and, therefore, forces firms to think harder when they interpret how to demonstrate compliance. Or is it that US rules are too proscriptive and, therefore, the focus is on the "dos" and "don'ts" versus the broader intent? This results in regulators going further and further down the wormhole issuing more regulations or guidance to get the behavior expected.

Reviewing the four Consumer Duty outcomes in comparison to US rules and guidance

1. Governance of products and services

This section of the Duty is intended to ensure that products and services are fit for purpose to aid consumers in achieving their financial objectives and avoid foreseeable harm. It goes on to describe the need for firms to identify a target market for the product and to include the characteristics, risk profile and complexity of the product or service. It also encourages firms to test concepts under various scenarios including analyzing the potential vulnerability of characteristics of some segments of that target market.

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Suggested resources to aid in determining vulnerability may include holding focus groups with customers who fall into this aspect of the target market, consumer groups or organizations that support these types of customers, and third parties to review products from the characteristics of vulnerability.

Indicators of vulnerability include the elderly, people with disabilities and minority groups or ethnic individuals who are more likely to be living in poverty. The section further goes on to warn firms that being sensitive to these segments of the target market should not lead to discriminatory practices which would violate the Equality Act 2010. In addition, it sets expectations around a product distribution strategy fitting the target market.

In the US, there are a variety of laws and guidance against discrimination practices. Two that immediately jump to mind are the Equal Credit Opportunity Act (ECOA) and guidance against Elderly Abuse.

In addition, the Federal Trade Commission (FTC) requires claims in advertisements to be truthful, cannot be deceptive or unfair, and must be evidence-based. US financial services firms have been holding market focus groups, hiring third parties, and so on to evaluate products and distribution channels for decades. However, the unique difference with the Duty is it requires marketing strategies to include a focus, not only on sales or market penetration but understanding the possible impact on customers' financial goals, especially the most vulnerable.

This is an admirable concept that may not require more dollars spent on marketing strategy but instead focuses the same dollars on evaluating products through the customer lens of financial benefits. There are US firms that would maintain they are already doing this level of evaluation by looking for services that would help individuals who may not be the higher-end client. For example, this might include products and services such as credit card promotional interest rates, credit card balance transfers at a lower interest, payday lending, overdraft on deposit accounts for several days with little or no fees, and small-dollar lending.

However, are these services really providing financial benefits? Or are they keeping customers in a cycle of never-ending debt while helping firms focus on beating out the competition to increase market share and make profits for their shareholders?

2. Price and value

The key concepts in this section of the Duty focus on customers getting value for their money. This would include identifying unsuitable features that can lead to customer harm or frustrate customers' use of the product, or poor communication and support. Firms must assess:

- the benefits that may be provided and the quality of the product or service,
- product or service limitations; and
- the expected total price a customer will pay including fees over the lifetime of the relationship.

Firms are expected to perform these assessments during the initial development and throughout the life cycle of the product. A good example provided in the Duty is the Buy Now Pay Later (BNPL) scenario where consumers are buying items using credit with zero interest split over several installments or to be paid at the end of the month. Most of these consumers end up paying considerable fees due to default. The fees may be reasonable, but customers may not be thinking about the implications of defaulting on their credit and therefore the product is not providing fair value. the Duty expects UK firms to push beyond the "buyer beware" approach and focus on helping consumers protect their finances in the long term.

In the US market, we have a variety of credit product examples, as cited before, that may not provide fair value even if they are reasonably priced. Analysis is performed around the possibility of past dues and defaults. However, the primary focus of these analyses is to calculate reserves for loan loss to protect the financial organizations' bottom line. It is not at all focused on the implications for consumer financial well-being. The Truth in Lending regulation addresses appropriate disclosures and notices to consumers in the US. There are no specific federal laws on excessive rates or fees. However, there is regulatory guidance on overdraft fees and many states have laws on interest rate limits (not necessarily on credit cards).

3. Consumer Understanding

This section of the Duty addresses consumer communications that enable understanding of the products and services. Firms are expected to support their customers by helping them make informed decisions. Customers should be given information at the right time in the product cycle, and it should be easy to understand.

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In addition, communications should be tailored for each audience, especially those considered to be vulnerable. These practices apply throughout the life cycle of the product or service. the Duty requests that firms put themselves in "customers' shoes" when reviewing communications on the various channels (in person, online, mailings, call centers, and so on) for clarity and understanding. Furthermore, the Duty encourages firms to keep in mind the reading and financial literacy of their audience to ensure communications are geared in such a way that the target market can understand. In addition, this section notes that lengthy and technical communication pieces results in customers not fully grasping the key points.

In the US, there have been a few regulations that have been enacted to help consumers understand disclosures provided to them. In the mortgage arena, TILA-RESPA Integrated Disclosure (TRID) was the biggest change post-Dodd-Frank that required new types and formats of disclosure to make the financial information associated with the mortgage easier for consumers to grasp. The broader Unfair or Abusive Acts and Practices (UDAAP) that is enforced by the Consumer Financial Protection Bureau (CFPB) and the FTC covers aspects of this section of the Duty.

There are numerous bulletins published by the CFPB providing guidance and reinforcing clarity in communications around different situations to avoid UDAAP. The most recent flurry followed the global pandemic where firms were having to communicate government relief or forbearance to mortgages and student loans and the implications when the forbearance ended. I believe if you surveyed most Americans who were affected, they would say the communications were "as clear as mud".

4. Consumer Support

The Consumer Support section of the Duty advises firms to provide support that meets the customers' needs. Thereby enabling consumers to realize the benefits of the products and services they buy. If a customer cannot properly use and enjoy the product or services, it is unlikely to offer fair value.

Here are examples of good consumer support practices:

- Delivery and support systems should meet the needs of the customer.
- Ensure appropriate friction in the delivery process throughout the product's lifecycle to mitigate the potential risk of harm.
- Provide customers with opportunities to understand and assess their options.
- Firms should monitor the quality of the customer support provided, holding to the same standards as used to help generate sales and revenues. For example:
  - Customers should be able to switch products, make changes, or leave the services as easily as it is to sign up.
  - Waiting times for customer service or support should not be any higher than it was to enroll on the product or service.
  - Support processes should avoid causing foreseeable harm and enable customers to pursue their financial objectives.

In the US, many of the customer support implications are addressed as part of customer complaints. This is not to say that designing effective and efficient consumer support is not a goal. However, it often suffers as firms try to balance both: the efficient part of the equation tends to come out on top.

The CFPB approach to getting firms to focus on providing better customer support has evolved into building out an entire program on complaints handling, where consumers can report directly to the agency. The entire process within the firm and by the regulator is focused on the reactive not the proactive. There are efforts in some firms to look for patterns and perform root cause analysis on complaints to try to fix the problem upstream. However, resources allocated to these efforts are often lacking and keep firms in a reactionary mode.

How would a US compliance team need to change if a US version of the Duty existed?

The Duty's outcomes-based approach focuses on upfront efforts from product design right through to product support. In most FIs, strategic marketing, and support systems design, has limited involvement from compliance teams whose primary focus is ensuring disclosure documents, advertising mailers or support setup is within the letter of the law. Compliance teams would have to regard their thinking to aid in scenario analysis as it pertains to the financial benefits and positive financial outcomes for their customers while still managing the variety of specific regulations.

The Duty Guidance publication provides good examples of the types of analysis and monitoring that would need to be in place in UK firms after 31 July. Most of the data exists in US and UK firms today. However, looking at this information through a different lens will be a major challenge for both firm leadership and compliance teams. The primary challenge is culture. Within the US market, firms are focused on beating out competition and growing the bottom line. Developing a cultural mindset about consumer outcomes and financial benefits is not grained in For Profit FIS.

Secondly, the third-party vendors that exist today to support marketing, advertising, and product development, are also not wired to think beyond how to get the customer to buy the product and how to make the product sticky (e.g., customer retention tactics). These firms are not geared towards analyzing the longer-term effects of customers' purchase of products and services with a focus on the financial health of the customer. Organizations may need to employ more individuals from the non-profit sector to make this dynamic shift.

Ethics and Conduct in a new wrapper

I believe US financial services firms would struggle to operate with principles-based rules. There have been years of regulations focused on consumer protection laws that some firms continue to find themselves running afoul — whether intentionally or unintentionally. The Duty broadly encompasses many UK laws that are like US laws, albeit very principles-based.

However, the concept of doing the right thing for the consumer in all aspects of the product or service lifecycle will be a challenge even in the UK. The one advantage the UK may have over the US is in their ability to make this work because there is less competition.

The number of banks and other financial services in the UK is much smaller than in the US. Therefore, less competition should continue to bolster collaboration when it comes to managing regulatory risk.

US regulatory agencies need to do something different to push conduct and ethics to the forefront of a firm's dealings with US consumers. I have mentioned in prior articles the need for more financial accountability at the executive leadership and board level in the way of individual fines and compensation claw-backs. However, financial penalties can only occur after the fact. Given the US focus on compensation, maybe a new model could be incentives and bonuses are only paid to executives based on the analysis of good customer outcomes.

Another option might include prior approval by a regulatory agency of products and services before being put on the market based on due diligence done on good customer outcomes and financial benefits — almost like the FDA approval of drugs before they are put on the market.

It will be interesting to see how UK firms implement the Duty and demonstrate compliance. The US should pay attention as this unfolds. The Duty's underlying unspoken theme reflects the expectation that firms are going to operate at a higher level of conduct and ethics when dealing with consumers.

If it works, the US might want to take a page or two out of this new regime.

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