The new Consumer Duty: Comments on the Consultation Paper

1 My background

1.1 I am an occupational psychologist and have spent my career working with service organisations, including financial services, since the 1970s. I have been a long-term critic of our approach to regulation. I have received numerous academic awards for my contribution to management science.

2 The new Consumer Duty represents a profoundly new approach to regulation

2.1 Regulation by principles rather than rules is to shift the locus of control from the regulator to the regulated. It will foster a culture of responsibility rather than compliance.

2.2 In my work with service organisations I have learned that there is a systemic relationship between purpose, measures and method; that is to say it exists in all organisations for good or ill. When regulators specify matters of measurement or method, they create a compliance culture (satisfy the regulator's specifications) which frequently works against the purpose (satisfy customers) and constrains method – how the work works. I have published plenty of evidence of this phenomenon. Organisations can receive good ratings from regulators yet be poor at serving customers and wasteful in terms of resources.

2.3 By limiting regulation to principles, the onus is put on leaders of organisations to make choices of measures and methods, making regulation a more transparent process (the choices will have to be declared), removing the scope to hide behind evidence of compliance, and, more importantly, will liberate method, increasing innovation.

2.4 The new Consumer Duty thus represents a ground-breaking approach that should attract the interest of all regulators.

3 Concerns amongst industry commentators are to be expected

3.1 When principles, rather than rules, are employed it is natural that those who have spent their careers complying with rules have uncertainty about what to do. It should be no surprise that respondents are concerned that outcome-based regulation would be inherently less clear than detailed rules, rules are what they are used to. The consultation also reveals concerns about the new Duty limiting the ability to deliver good outcomes, the risk of unintended consequences and the potential for negatively impacting on competition and creating higher costs.

Vanguard, Villiers House, 1 Nelson Street, Buckingham, MK18 1BU
t: 01280 822255 f: 01280 822266 email: office@vanguardconsult.co.uk www.vanguard-method.com
Vanguard Consulting Ltd. Reg. no. 2207133

3.2 These concerns illustrate the mind-set of the respondents. The management ethos in financial services is dominated by cost management. None is a real cause for concern.

4 Evidence of the need is overwhelming

4.1 The Consultation Paper includes many examples of serious failure to deliver good consumer outcomes. My experience would suggest these are just the most visible and egregious. Many more prosaic examples can be found in all financial services organisations designed and managed in a conventional command-and-control, cost-focused manner. While, for example, difficulty in using digital services or understanding forms may be considered trivial to managers these and other failures are not trivial to customers. It is normal in such organisations to discover that as much as 60 to 95% of demands from customers are what I call failure demand (which I define as *demand caused by a failure to do something or do something right for the customer*) – representing the current extent of failure to provide Consumer Duty.

5 Causes of failure to provide Duty

5.1 The causes of failure are to be found in the management ethos. Financial services organisations are designed on a factory logic where activity is treated as cost and thus the operational features are front- and back-offices, activity management, standardisation, specialisation, digitisation and so on where the primary purpose is for leaders to achieve incentives related to cost and/or revenue.

5.2 When you consider the volume of failure demand and the consequence that has for operating capacity it is clear to see that better service will result in lower operating costs. Fulfilling the purpose of Consumer Duty will have tremendous economic benefits.

6 The economics of Consumer Duty

6.1 To put it at its simplest: If a service organisation is designed to understand each and every customer's need and then works to serve that and only that the cost of service provision will be optimised. Working this way is to focus on value, not cost, but costs fall as a consequence. Leaders become competent in understanding the relationship between demand and capacity. As services improve, capacity increases and more work can be done with fewer resources. I have plenty of evidence of dramatic improvements in customer service resulting in equally dramatic improvements in revenue and operating costs.

7 Designing for Consumer Duty

7.1 The relationship between customers and financial services firms will always be asymmetric. Consumer Duty, if it to be exercised in an exemplary manner, will require a transaction design that recognizes asymmetry and provides relevant expertise according to each and every customer's need and circumstances. Consumer Duty will be largely unachievable in conventional service designs owing to current management controls.

8 Understanding what matters to customers

8.1 The prerequisite for an effective service design is thorough knowledge of customer demand in customer terms. What becomes apparent is that demand is largely predictable – something few leaders would believe – and this enables a service design that matches expertise with customer demand – getting it right first time is a natural consequence. It becomes straightforward to define and measure good customer outcomes.

8.2 The focus on knowledge of customer demand makes any practice resulting in negative effects identifiable immediately. It provides consumer protection through prevention more than inspection.

9 It's customers, not markets

9.1 I note the interest in Big Data and behavioural economics. It being a desire amongst economists to treat consumers as a market, using analysis of characteristics of individuals and their behaviour to make judgements. There is a risk that expensive investments will lead to difficult decisions. For example; data about car-driving behaviour may be used to differentiate customers, but are the data sufficient to ensure such treatment is fair? The challenges for such approaches are: is any decision legitimate and legal and can the data lead to productive decisions about the design and management of customer service?

9.2 An example of the failure of Big Data to enable productive decisions is adult social care, a good example because like financial services care services deal with a high variety of customers. A Big Data project collated masses of data about individuals and their characteristics but was of no utility in determining how to design and manage care services for the better. When, by contrast, leaders had knowledge of demand in customer terms, its type, frequency and predictability, they were able to design a care system that helps more people, more effectively and at lower cost.

9.3 There is a world of difference between collating masses of data about characteristics of individuals and their behaviour and understanding demand in customer terms. Aggregated data makes us think of customers as types, leading us to design work accordingly, demand data makes us think about the real needs of actual customers. Which is better at absorbing the variety of customer demand? Which has the least risk?

9.4 The publications on behavioural economics and financial services appear to seek to shoehorn known problems of customer service into popular theories. For example, mis-selling PPI is attributed to 'behavioural bias' in consumers; arguing that consumers misunderstood PPI pricing and limitations in its cover. The example that appears frequently is customers agreeing to a low-cost mortgage which is only sold in conjunction with PPI. The reality is this was a management-inspired idea to profit from sales. I have also witnessed, first-hand, PPI sales driven by incentives in the front line, for example targeting a proportion of sales that had to have PPI attached in order to trigger a bonus. I also saw how this could result in fewer sales. If an agent was exactly on target and had a sale where the customer refused PPI, the agent wouldn't fulfil the sale as it would cost them their bonus.

10 The greatest risks

10.1 The first is spending money on large-scale IT analytic projects with uncertain outcomes. The second is creating a massive change project with its associated bureaucracy that consumes resources exchanging opinions based on their current ways of thinking about management.

10.2 The simpler, effective and arresting way to get started with Consumer Duty is to understand demand in customer terms from today's customers.

11 Supervision

11.1 The principles of Consumer Duty are clear. The purpose is set. Supervisors need only to ask what choices have been made in terms of method and measures and, then, should go see how that's working in the work.