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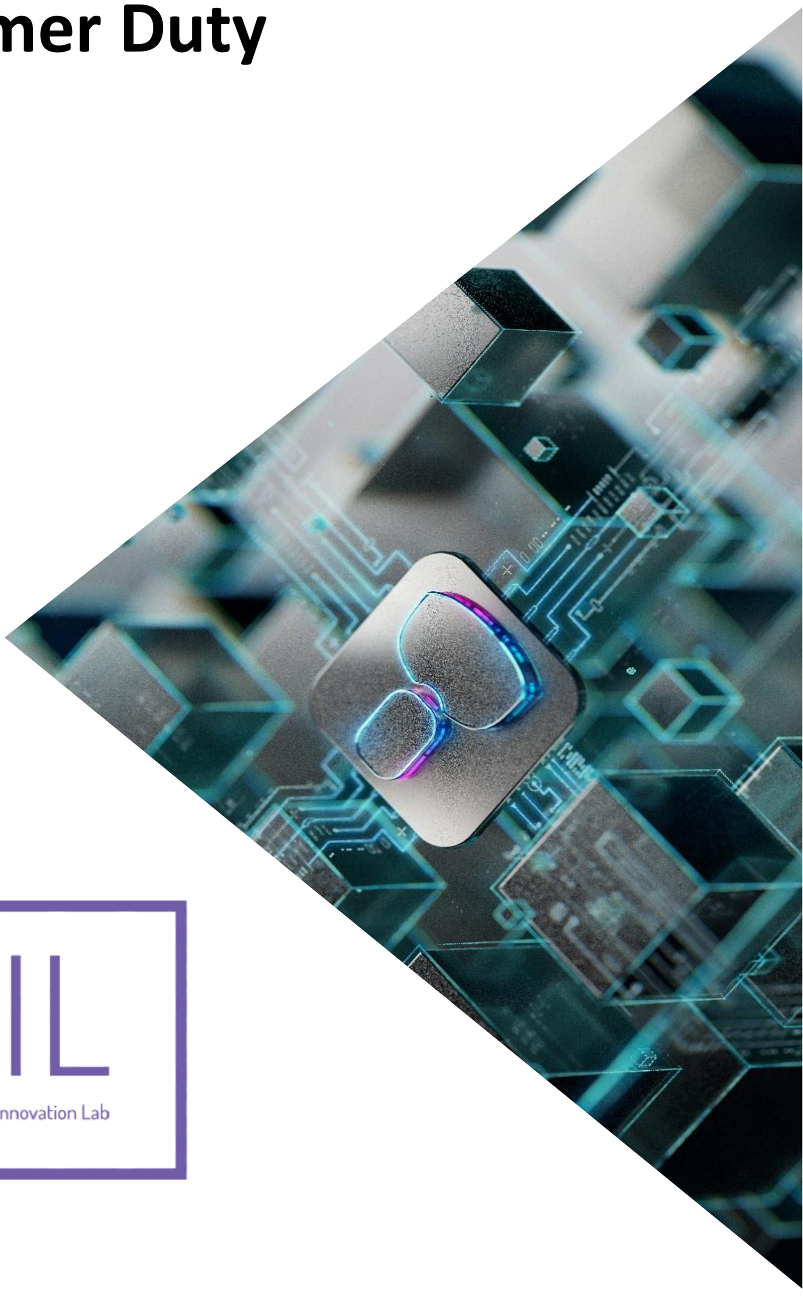
Consumers as Innovators and the UK Financial Conduct Authority's Consumer Duty



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Consumers as Innovators and the UK Financial Conduct Authority's Consumer Duty

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Consumers as Innovators and the UK Financial Conduct Authority's Consumer Duty

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January 2025

Abstract:

We address the scope, purpose, and initial implementation from July 2023 of the UK Financial Conduct Authority's (FCA) Consumer Duty. As an instance of financial regulation innovation, the Consumer Duty is having a major impact in the financial services sector and has impacted on the organisation of markets for financial services and in the interactions of consumers and providers. The Duty brings to prominence the ways in which the production, marketing and use of financial services products and services are strongly interrelated. It highlights: (1) Consumers' financial literacy; (2) Providers' confidence that their products and services and communications about these are being understood; and (3) How providers are anticipating and coping with vulnerability among their customers. Together, these recognise consumers as being active, engaged, adaptive and innovative. We position the paper in terms of active consumption and market and marketing channels so as to focus on active consumers, and consumer vulnerability. To illustrate how the Consumer Duty is shaping the development, marketing and uses of financial services, we explore a sample of cases reported by the Financial Ombudsman Service, in which the issues referenced are akin to the elements addressed in the Consumer Duty. We find that consumer understanding is a prominent factor, which also impacts on a number of other categories and subcategories. We also see, through the perspective of Consumer Duty, a somewhat pacified or pacifying view of consumers and in some instances, tensions emerging between consumer adaptations and the contractual terms for financial products and services. This adds to our conceptual framing of market channel and its implications for consumer vulnerability.

Key words: Financial Regulation, Consumer Duty, Market Channels, Active Consumers, Vulnerability, Innovation

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1. Introduction

The UK regulator, the Financial Conduct Authority (FCA), implemented the Consumer Duty in July 2023 (Financial Conduct Authority, 2022). Consumer interests are always of critical importance to regulation, and the scope and impact of financial services extend beyond consumer protection in established products and services. In terms of policy and society, financial services take on the long-term qualities of utility, identity, security, and raise questions of societal financial literacy, financial and digital inclusion, and addressing vulnerability. These features are recognised in the Consumer Duty. Overall, the Consumer Duty introduces a significant change in that financial services providers need to demonstrate that they are focusing on good outcomes for consumers in product and service development, their communications about products and services, and in the continuing support offered to consumers.

As our starting point, we highlight one sentence from the Consumer Duty framework to illustrate the purpose of our paper. To be suitable financial products and services, these should provide good outcomes for consumers: "Consumers are sold and receive products and services that have been designed to meet their needs, characteristics and objectives leading to a reduction in the number of upheld complaints about products and services not working as expected" (S22/9 Chapter 1 Financial Conduct Authority, A New Consumer Duty Feedback to CP21/36 and final rules).

The emphasis on 'designed to meet their needs' is of interest for this paper as it emphasises an initial product and service development phase undertaken by financial services providers. The explicit focus on good outcomes for consumers draws attention to how financial services providers and regulators are developing their understanding of the ways in which consumers experience benefits, requirements, and costs of adopting and adapting products and services. Many financial products and services are long-lasting and potentially complex with multiple dimensions. Consequently, being a consumer of financial services requires consumers to have views on, and the capabilities of articulating about, their future needs, reflections on risk over time, and how they can combine different products and services.

We explore active views of consumers, of consumers being adaptive, innovative, capable and coping in their purchase and use of financial services and evaluate the extent to which this is overlooked in the Consumer Duty. We see a great deal of evidence of consumers developing their own portfolios across different producers, and on occasion putting established products to uses not foreseen by financial services providers. Following Shove and Araujo (2010, p. 16): 'Taking objects and their materiality seriously has important implications for our understanding of ordinary consumption. To begin with, it calls for a notion of active consumers with particular sets of skills and competencies and it regards value as something that is only ever realised through incorporating objects into practices'.

Our empirical analysis is motivated by the suggested measure in the Consumer Duty, of 'a reduction in the number of upheld complaints'. This statement directs us to the reports from complaints made to the UK Financial Services Ombudsman. This is a unique database, recently related to the Consumer Duty, to include in each adjudication report accounts of the interactions among consumers and producers of financial services products, as mediated by regulation. We align the Consumer Duty with a kind of market – if not marketing – channel, understood as a 'vertical groove' worked into a market that connects producers, intermediaries, regulators and consumers. A channel enhances the vertical visibility and expectations of product and service development, guidance, advice, exchange and use to one another.

Given our analysis, we suggest that FinTech models can address what we identify as a need for a deeper understating of active consumers, to be reflected in product and service development. The introduction of FinTech offers the potential for greater understanding and the embedding of additional qualities and benefits as consumer bring insights into products, and in analysing data as consumers engage with providers, products and services through purchase and use. This is the case whether focusing on consumers' buying from FinTechs, financial services products and services modified through B2B or in-house financial services functions as contributions upstream in the process of value development.

FinTech in its many modes and sub-sectors, through start-ups, scale-ups, social enterprise, in-house teams in established organisations, and public sector, focuses on innovation. The focus has been on the development, production and distribution of new products and services, and on ways of producing new products and services mostly in business-to-business (B2B) sectors, with some featuring directly in business-to-consumer (B2C) offers. These have implications for how consumers are, and can be, active and contributing to the continuing production and formatting for and in their use of financial services. In other words, we see consumers through their learning-by-using of products and services, and learning about their financial objectives, requirements and capabilities to use products and improvise among those products being offered. Related, consumers may be vulnerable at any moment as they engage with such learning, improving and coping.

2 Questions

We address the following questions:

- In which ways do Financial Services companies, as they develop and market financial services products, imply that customers, consumers, and end-users become innovators too as they use financial products and services?
- What do producers and consumers tend to exchange additional to a product/service and payment?
- What capabilities and skills do consumers need to draw out the value of their financial services products and services?

Together, these questions imply an active vision of consumers and consumption, and potentially vulnerability, requiring capabilities, plans, adaptation, improvisation, and potentially innovation, in product and service use. We gain insight into the interactions of producers and consumers, mediated by regulation, through the reports of the UK Financial Services Ombudsman, in resolving complaints made with relevance to the Consumer Duty. The questions indicate spaces for services and products in development and use to be enabled through FinTech, and for FinTech to establish and draw upon feedback loops for consumer data.

3. Literature: Consumers and Innovation

3.1 Active consumers

The three questions (above) draw from views of consumers and consumption as active, learning and engaged (Shove and Araujo, 2010). We will extend and evaluate the view of active consumers with the perspective of consumers as innovators (Scaraboto and Fischer, 2023). We evaluate the extent to which consumers need also to be innovators to participate in financial services, using financial services and products effectively and gaining value from them, including as these are augmented through FinTech developments. In other words, we see consumers as contributing to product and service development and refinement, close to their use or consumption, so that they can benefit from what are increasingly FinTech and FinTech-enabled financial products and services (Thomke and von Hippel, 2002). This may be in a portfolio sense, of combining different products and services, which can have different time horizons – as with loans, mortgages, insurance, and pensions – to address financial needs and goals. Active consumption is with specific products, and across a combination of these, requiring consumer capabilities in combination and inter-operability. Engaging the customer in innovation can help to improve customer experience not only in terms of measurable outcomes such as product or cost-related outcomes, but also the cognitive, social and personal benefits of interacting with the provider, product development and delivery. When the consumer is engaged in product and process innovation through interactions that encourage user input, it promotes opportunities to learn, to discuss product features with others, and to improve their overall product knowledge. These stimulate a sense of self-efficacy and satisfaction that comes with having engaged in learning about products that matter to them, which in turn can positively influence loyalty towards the firm that encourages consumer engagement in innovation (Nambisan & Baron, 2007).

From the perspective of research in marketing and consumption, financial services can be complex, long-lasting, combined, uncertain in financial outcome, requiring complementary knowledge, and the purchase of supporting technology (Geiger and Kjellberg, 2021). At the same time, financial services are a necessity, comparable with a utility, requiring and then validating and carrying forward identity, and raising policy and social questions for financial and digital inclusion. The quality of utility is seen in the continuing prominent focus in the Consumer Duty of financial services providers explaining how they support consumers and address consumer vulnerability.

In response to an active, engaged and learning view of consumers and consumption, we will explore what FinTech and Financial Services producers may do in terms of their design in anticipating the skills and capabilities – the FinTech and financial services literacy and capabilities – of their customers as well as their financial objectives. For example, do producers, in their product/service or business model design, their user experience design, require their customers and/or their customers' customers to share risk? Or to co-produce part of the product and service development, for example in bringing skills, capabilities, and other platform resources such as smart phone, digital identity, credit rating (Scaraboto and Fischer, 2023)? And how does this expectation or requirement sit alongside the Consumer Duty?

Corporate growth, scale, competition, entry, the prospect of continuing producer-led innovation and its coordination, all influence and are influenced by the growth of markets, and the coordination and interactions among market actors (Geiger and Kjellberg, 2021). Markets are forms and spaces for social and economic organising, and a focus for the interest among consumers in joining-in in buying financial products and services and bringing these into their lives. Well-functioning markets allow for the division and coordination of expertise as a vital, dynamic and long-run process of economic growth, the interplay of specialisation and coordination in knowledge, limited by the extent of markets. We can add to this producer-led view, the contributions of consumers and the regulator, potentially in expansion of the market for financial services, and addressing the requirements of consumers to bring or develop capabilities, skills and resources to participate in that market and to use those products and services offered there.

3.2 Market and marketing channels

Part of the way in which we think the Consumer Duty can impact on the organisation of markets is in establishing distinct and new communications channels. Communication is one of the key four criteria in the Consumer Duty, contributing to good outcomes for consumers. We choose our words carefully, as the understanding of communication in the Consumer Duty is that it should be informative, in plain language, and not seeking to advertise or persuade. There is a strong intersection with UK GDPR and the permissions given by consumers to receive advertising, also governed by Advertising Standards, as distinct from the information they need to receive to describe products and services. Other channels can be developed – and signalled as such – for the purposes of advertising and promotion, and producers need to be careful in undertaking, indeed gaining permission to undertake, different kinds of communication.

Despite the regulatory conditions qualifying and defining communications, we interpret the communications part of the Consumer Duty as establishing a new market (and not marketing) channel in financial services, connecting product/service producers with consumers. The costs of establishing and maintaining this channel are considerable, and have implications for other channels, which owing to the regulatory requirements in communications, are more clearly marketing channels.

Our reflections led us to the concept of market and marketing channels, a long-standing and somewhat neglected concept in marketing (Alderson and Cox, 1948, Alderson, 1964). Alderson argued that market and marketing channels are 'organized behavior systems', which he termed 'transvectives'. They are a 'complex of human behavior' and are required to set up, operate and continuously remodel an on-going market. Those who develop and use market and marketing channels 'exert great effort continuously if there is to be the intricate organization required to inform potential buyers and sellers, bring them together in the actual negotiation of a transaction, and make it possible for them to carry out all transactions negotiated' (Alderson and Cox, 1948, p. 142). In other words, market and marketing channels are additional investments made into markets, typically co-invested and co-produced in use by producers, intermediaries – such as regulators – and end-users, to accompany especially with communications the production, exchange and use of a product or service.

As Alderson (1964, p. 151) pointed out: 'A market changes day by day through the very fact that goods are bought and sold. While evaluation is taking place within a marketing structure, the structure itself is being rendered weaker or stronger and the changes in organization which follow will have an impact on tomorrow's evaluations'. And 'Whether such a channel constitute(s) a behavior system … certainly a system in the sense of persistent interaction' (ibid.). Further, 'Rivalry in organizing the market is a fundamental force in market dynamics'.

Hulthén and Gadde (2007) revisit Alderson's concept of market or marketing channel, developing further the explanations of companies' strategies and behaviours. They argue that organisations in a channel can pursue, as ideal types and opposites, strategies of delaying, and if not delaying then speculating. Delaying means adapting versions of products or consumers that meet consumer needs and expectations, typically assembled and customised close to a point of purchase and use. Alternatively, speculating sees producers assembling products and services at some distance from customer purchase and use. Each approach has implications for marketing communications and can be seen in the Consumer Duty. An implication, not pursued by Hulthén and Gadde, is that consumers become active and engaged in market or marketing channels, contributing to transvection and sorting, whether engaging with marketing activities following either the speculative or the highly engaged and adaptive types.

In recent contributions, researchers have begun focusing on role of marketers and others, including regulators, in shaping the markets by and through which products and services may be promoted, exchanged and acquired (Araujo, et al., 2010). The point being that as they devise and implement marketing strategy, marketers can aim to shape and affect the qualities of a market itself, to enhance marketing activities with consumers and brands. A similar logic applies to regulators. There are often specific rules and customs of that underlying market, which marketers and regulators should understand in their market-shaping efforts. Referring to Alderson (1964), rivalry – in organising a market and in the context of other organising work among market participants – is possibly too strong a term for the actions of the UK Financial Conduct Authority in implementing the Consumer Duty. Nevertheless, by defining a particular form of communication, and including within this the resolution of complaints, this changes the set of market and marketing arrangements, including channels (Siltaloppi and Varga, 2017). It also demonstrates the potential of communications practices and, as we identify later in this paper, the development of other market and marketing channels elsewhere in the market.

3.3 Consumer vulnerability

The development of market and marketing channels, or transvectives, provides a way of understating the activities of consumers, understood as engaged and innovative regarding the conditions of purchase and use of financial services. Adopting Hulthén and Gadde's (2007) terms, a speculative approach by financial services providers may lead to a burden on consumers to undertake their own adaptations or workarounds with products and services already developed and produced. By contrast, an adaptive approach may require considerable self-awareness and self-knowledge among consumers of what their financial objectives are. By including the understanding of active consumers as part of a transvective, or market channel, one can reflect on the degree to which all those involved in production and use are successful in understanding their entanglements in their own and their views of others' cultural, technical, economic and social entanglements (Miller, 2002; Slater, 2002). Following Miller (2002, p. 227), '… the better a business reflects on the totalizing moment of purchase by acknowledging the rich mixture of factors that consumers are looking for, the more they are likely to succeed. The problem is whether business could ever be entangled enough to reflect the totalizing acts of the purchaser'.

One consequence of entangling and totalising (i.e., how a particular financial product affects many other aspects of their lives in purchase and use, culturally, emotionally, materially) is to understand the conditions of vulnerability that consumers may encounter or exhibit at any moment in their consumer and user experiences. Vulnerability is in the sense of those who struggle to be effective as active consumers in particular contexts (Hill and Sharma, 2020). Vulnerability has been a prominent feature of the Consumer Duty. Marketing researchers have for some time been explaining vulnerability as a matter of as a matter of consumers' access to and uses of resources and capabilities in using markets, making purchases and using products or services (Varman and Vijay, 2018). While these may cross over with individual circumstances as captured, for example, by protected characteristics, the point is to consider consumers' particular access to and capabilities in deploying resources in the context of a product or service (Varman and Meshram, 2024).

The case of Consumer Duty highlights the importance of market participants understanding the rules and underlying customs of the market, especially regarding forms of communication. Regulations provide many vital nuances as to how channels may be formed, used and interpreted for the purposes of different forms of communication to accompany the development, exchange and use of financial products and services. The

Consumer Duty makes this a critical part of a financial services product or service offer. There is an emphasis on plain language in describing a product or service, distinct from other communications which need to signal clearly as being advertising and promotion, distinct from product or service information. As reinforced by the UK Financial Ombudsman, a communications channel is a market channel, establishing expectation of language, an expected or permitted form or style of communication, and an accountability, as a quality of a product or service. A recent webinar and blog from Pinsent Masons explain the practical implications of this point about how communications should be arranged in recognition of the Consumer Duty and other regulations (Wynn and Jackson, 2024).

Alongside our understanding of consumers and of consumption is a need to reflect on the organisation of the market. We expect markets to be dynamic, continually made and remade as products and services are bought, sold, evaluated, upgraded, and supported through their use beyond initial purchase. Simply in outline terms, we have a sense of this, with view of the FCA as market regulator, setting out the Consumer Duty, the dimensions of good outcomes, and recognition of diverse groups engaging in that market, cohorts among consumers, providers and the products and services themselves.

4 Regulation, Compliance and Good Outcomes

Financial inclusion, critical to economic and social inclusion, and increasingly a dimension of digital inclusion, is a critical feature of the growth of the market for financial services. This means end-users, customers and consumers joining the market too. Research broadly on lead-users in innovation, and increasingly in consumer research, demonstrates that consumption is rarely a near-automated release of the benefits of a stable, 'boxed-in' product (good or service), that consumption is not a rapid and unproblematic endpoint on value creation. The style of regulation plays a critical role in shaping both goals and processes for a market, of mediating interactions in production, exchange and consumption or end-use.

The Consumer Duty is an example of outcomes or goals-based regulation. At the same time, it does not replace the long-established common law principles of caveat emptor, though qualified by the UK Consumer Rights Act (2015), and does not replace the fiduciary duty of financial services providers, so providing a range of standards including the Consumer Duty and principles against which the Financial Ombudsman Service (FOS) should consider. A feature of this is a lack of prescription about how regulatees achieve specific regulatory goals, which 'are generally cast at a high level, setting out broad principles, outcomes or standards that regulatees' actions must seek to achieve or satisfy. Goals involve both private and social goods/objectives' (Decker, 2018, p. 17). Furthermore, 'in determining how best to comply with a regulatory goal, regulatees are encouraged to use the information available to them and exercise judgement in making compliance decisions … [such that] ... the enforcement task … can involve establishing what constitutes an acceptable or desired level of achievement of the regulatory goals … and then applying some method of assessment of actual or expected performance against that performance standard or outcome' (ibid.).

In policy and regulation terms there is a recognition of the role that consumers play, and can play further, in expanding and drawing out the potential benefits of FinTech and financial services, including addressing the question of financial inclusion. The UK Financial Conduct Authority introduced the Consumer Duty in July 2023 (Financial Conduct Authority, 2022; Barrett, 2023). Consumer Duty is a contribution to support consumers and so add resilience, inclusion, and growth. It is potentially a policy innovation – broadly as an outcomes-based approach – as it orients regulation and the requirements for producers to demonstrate that they offer good outcomes to consumers. It also requires producers to test the documents, such as terms and conditions, on-boarding, statements, changes in service conditions, related to products and services. These are integral to products and services, with consumers needing to understand documents pertaining to their products and services, especially with respect to countering typical user biases uncovered in behavioural science (Cowry Consulting, 2023).

Consumer Duty is remarkable as a unifying principle, which has been introduced carefully in financial services and across multiple sectors and markets, along with guidance for firms in implementing this. The FCA is, arguably, playing a notable role in supporting customers, consumers, and end users, so supporting and extending the reach of FinTech, financial services, and overall, the extent of markets. The inclusion of ideas established in nudge and behavioural science (Thaler and Sunstein, 2009; Erta, et al., 2013) has been interesting as producers have tested the documents surrounding, articulating, and conveying their products and services, so at the same time by means of the Consumer Duty formalising the role of such documents as part of the product or service itself. The implication of behavioural science concepts being that we expect bias to be present normally in communications, interpretations, and choices. In other words, the Consumer Duty recognises, at least to a limited extent at key decision-moments, that consumers are active and learning agents, even to the extent of the documentation that describes financial products and services.

5 Method and Analysis

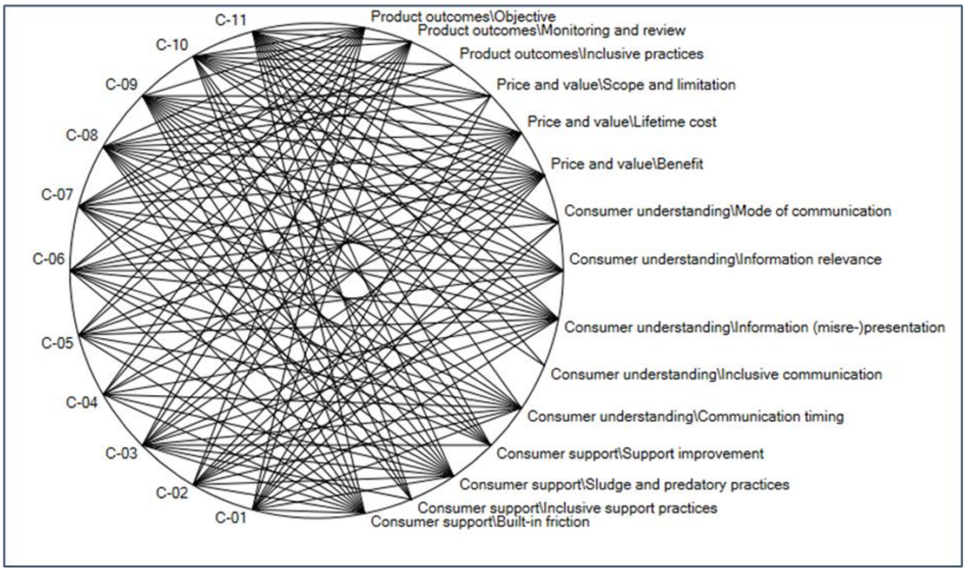
We draw on the analysis of the Financial Ombudsman Service (FOS) complaints, investigations and decisions to unpack consumer outcomes that tend to be at issue in products and contracts in the financial services sector. To conduct the search in the FOS database, we used queries that reflect the elements related to product/service, consumer support, price and understanding. The search focused on FOS decisions on credit products in the report for the period between August 2023 and November 2024, which included eleven cases. This was to enable us to frame the analysis with reference to the UK's Consumer Duty Guidance, which sets standards of care that firms should give to consumers in retail financial markets. While these are recent guidelines, they are built on previous regulations and serve as a key reference for good consumer outcomes in the UK financial services sector. We acknowledge that this is a particular database of cases that costumers and providers have not resolved through their own processes and interactions. Our interest in these cases is in the ways in which the terminology of the consumer duty and the process of investigation generate data, as reports that are available publicly, about the consumer duty. To a lesser extent, we are also motivated by the initial mention in the Consumer Duty of an objective to reduce the number of upheld complaints with the Financial Services Ombudsman.

First, we map the Consumer Duty's four dimensions, building on the framing of consumer outcomes that reflect product objective, consumer understanding, support, and price and value. We developed these dimensions further into subcategories drawn from the Consumer Duty's terminology that reflect issues around consumer needs and characteristics, clarity and fairness of contract terms and related communications, fair pricing (value for money), and quality of support, including whether and the extent to which product and business processes consider customer circumstances and vulnerabilities.

Having laid out the reference to consumer-focused outcomes, we conducted the analysis of the FOS complaints, investigations and decisions to gain insights into key issues around the outcomes that tend to be recalled in financial services contractual conflicts and FOS redress documents (see Figure 1). Accordingly, this paper follows a primarily deductive qualitative approach considering that coding was conducted with respect to a predefined framework, which serves as a reference for consumer-focused outcomes in financial services. While the paper uses the FCA Consumer Duty Guidance as a framework for referencing consumer outcomes, it varies sub-themes when necessary to capture issues that do not fit the predefined components. For example, the paper combines sludge and predatory practices under consumer support as they reflect closely knit practices in the complaints and investigations. It varies the mainly deductive approach to accommodate emergent patterns in the textual data when necessary. Therefore, the paper applies a hybrid method of thematic analysis (Elliott, 2018; Fife and Gossner, 2024).

We used an analytic approach to code the text in the FOS complaints, investigations and decisions. The analytic approach to text coding is a method in thematic analysis that labels and categorises a body of text data such as a set of sentences or a paragraph to abstract interpretation and meaning based on how closely the text reflects certain concepts and/or perceptions. We focused on the meanings abstracted from a body of text to structure the data and interpretation, instead of the use of individual text labels. This way the paper employs an analytic coding approach (Richards, 2015). Analytic coding had been employed to operationalise the deductive qualitative research design. We explore mixed methods to visualise the data.

Figure 1, Recurring themes in sample cases.



In Figure 1 (above), the links represent recurring references to the sub-themes of consumer outcomes across four dimensions in the observed cases. The four dimensions of consumer outcomes are (1) consumer support (2) consumer understanding (3) price and value (4) product outcomes. A case (C1-11) refers to a document of complaints, investigations and decisions. A code refers to a (sub-)theme of consumer outcomes. The reasoning behind this research framing and analysis is that unpacking the elements of the Consumer Duty's consumer outcomes that tend to be mostly recalled in consumer complaints and the FOS intervention can offer insights into the areas of consumer-business relationships (product, contract and contract implementation) that need attention in working towards good consumer outcomes. Where such elements reflect negative concerns such as breaches and unsatisfying outcomes, they may form a springboard for product (re-)development and delivery, and for improving consumer engagement, experience and outcomes in the future.

This indicates, following our theory discussion in Section 3 (above), that the FOS mediation, in addition to other FCA forums for consumer engagement, can serve as a regulator-mediated market channel. There is a possibility of rich information and insights into how firms might work around active and favourable engagement of consumers throughout the product cycle for good outcomes (Wynn and Jackson, 2024). As a channel, this can complement information that product manufacturers or producers derive from other market channels to help engage and enhance experience in the customer journey. Further, with the introduction of the Consumer Duty in July 2023, this could be introducing a new market channel, so impacting on any others already established, and with a condition of consumer understanding, plain language and countering potential behavioural biases in communications.

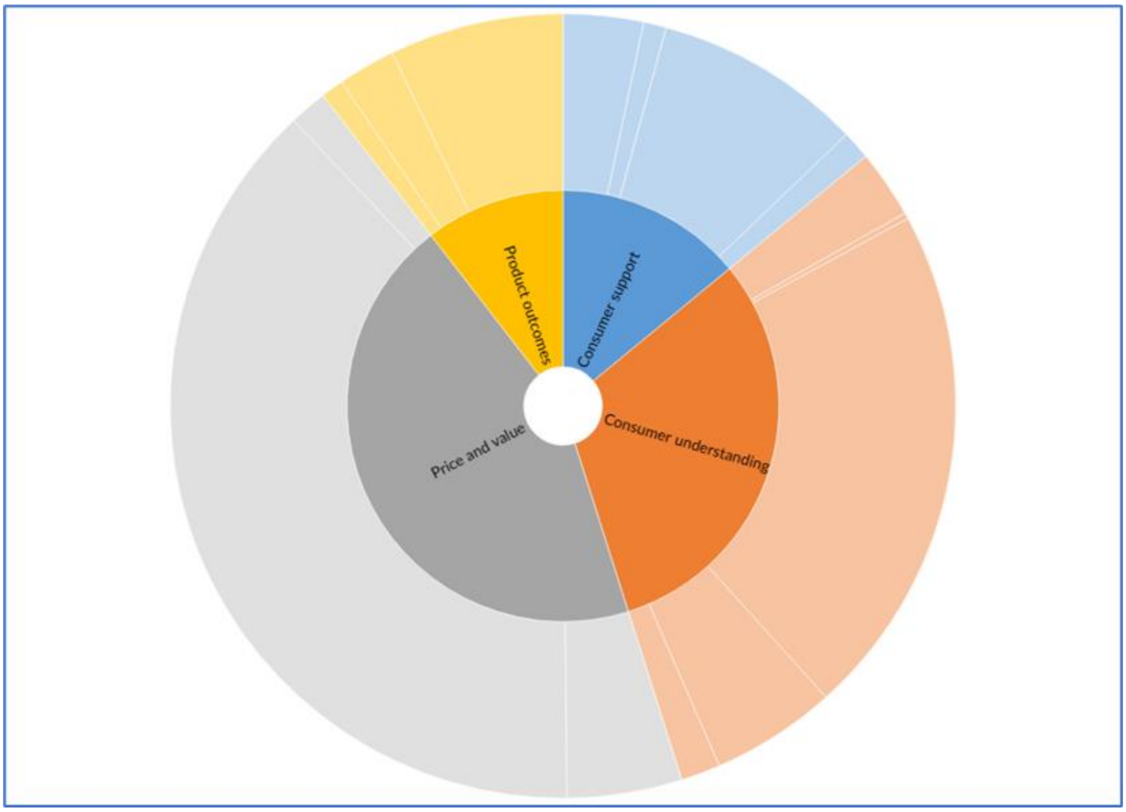
6 Findings: Regulator and Producer-mediated Channels of Consumer Innovation in Financial Services

6.1 Major issues around consumer outcomes in financial credit products

The exploratory analysis of the sample cases focuses on the consumer outcomes at issue. Outcomes at issue describe the consumer outcomes that the customer (or the customer's representative) tends to reference to motivate complaints filed against a company (that is the producer or financial services provider) with the FOS. Accordingly, the producer or provider's response to the complaints, investigations and decisions tend to follow a similar pattern of references as objections are intended to match and counter customers' claims. The FOS investigations and decisions also follow a similar pattern of references considering that the Service draws on relevant regulations, rulings and reports in arriving at its final decision on cases.

The price and value dimension of consumer outcomes is recalled as a significant issue in the contractual conflict and redress (Figure 2). This dimension and its components reflect the price that the consumer pays for a financial product in relation to its nature, quality and overall benefit. Therefore, price and value outcome does not mean offering a product at a low price in an absolute sense. In the context of the FOS redress examined, the contentious issue is centred around lifetime cost of the product (Figure 2 and Figure 3c, below). Lifetime cost captures all fees and charges— including commissions paid to a third party— throughout the contract between customers and firms. The nature of products (for example, whether they are truly exclusive in the case of holiday clubs), benefit (value and satisfaction derived) and scope/restriction (range of value and benefits) are drawn upon to motivate the cost element. Interests and commissions are recalled as the most significant contributors to lifetime cost.

Figure 2, The pattern of references to consumer outcomes across Price and value, Consumer understanding, Consumer support, Product outcome

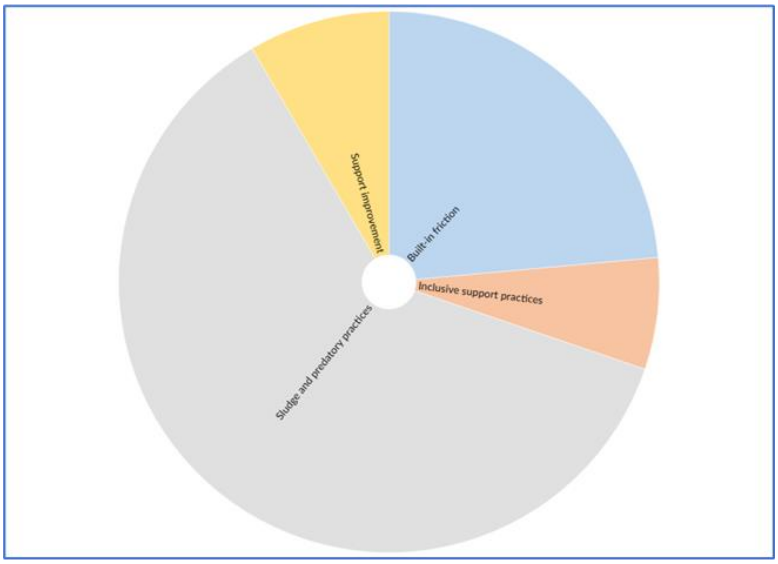


In line with the FCA's framing of price and value in the Consumer Duty Guide, an issue related to lifetime cost in the FOS redress —if driven by third party commissions— is not essentially considered harmful in itself, but whether it reflects the nature of the product and the recipient's efforts in providing or facilitating it. In addition to these, whether and how the relevant information about cost and benefits (in line with the customers' product objectives) is presented in contracts and associated communications during the relationship between customers and firms matter. The dominant recurrence of issues around consumer understanding alongside price and value, as reflected in Figures 2 (above) and 3b (below), underscores the importance of information needed to explain products, costs and benefits (see Figure 3c and 3d below for the framing and occurrence of these components).

While key information needed to understand products is helpful, the way the contract terms and associated communications are presented (clarity, partial/full disclosure and fairness) is the most significant component of consumer understanding. In the FOS cases, the aggrieved customers — and the Service in investigating and deciding the cases— are less concerned about high costs driven by commissions in absolute terms than whether the producer and/or its agent has provided clear and full disclosure of the producer-agent relationship, the amount to be paid in commission, the discretion of the producer/agent in setting the commission and why. As an aside, we also point out that such a relationship constitutes a market channel, and fits closely with the concept of transvective, as set out in Section 3 (above).

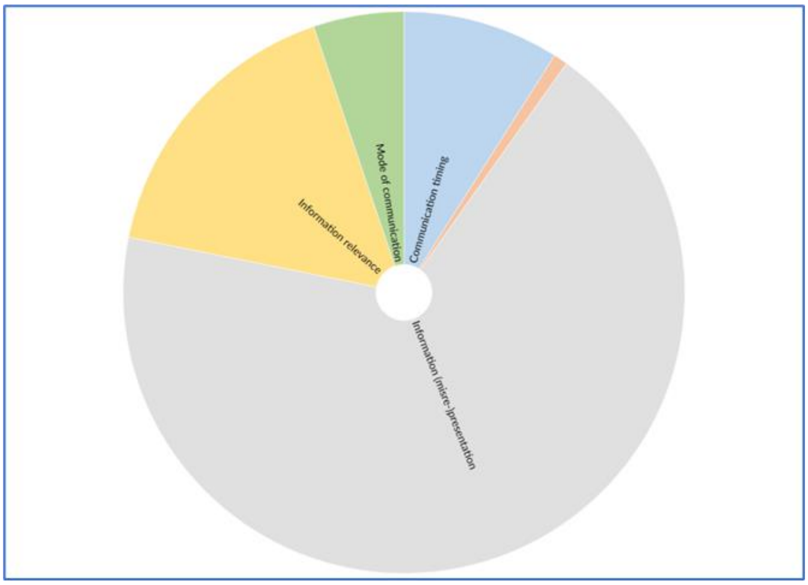
Figure 3 (a-d), Key sub-themes across dimensions of consumer outcomes

Consumer support 3(a)



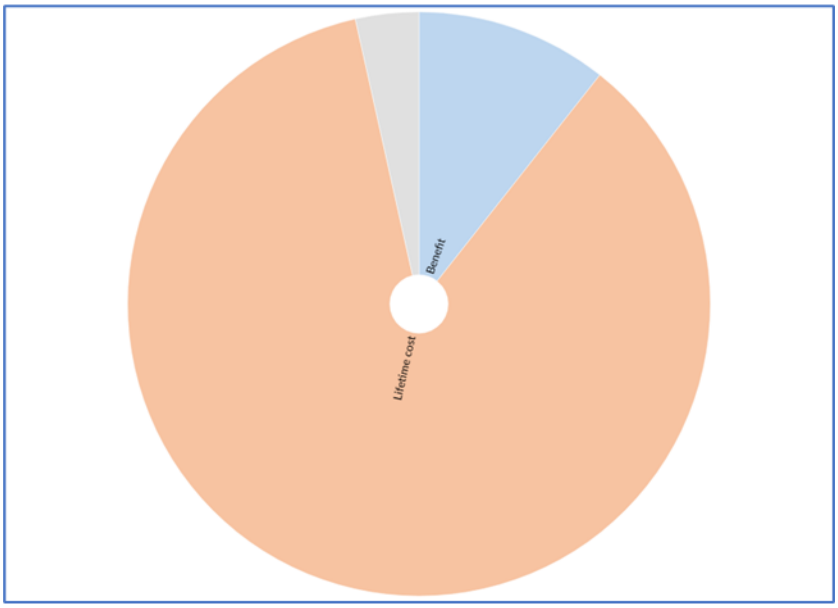
Built-in friction, Inclusive support practices, Sludge and predatory practices, Support improvement

Consumer understanding 3(b)



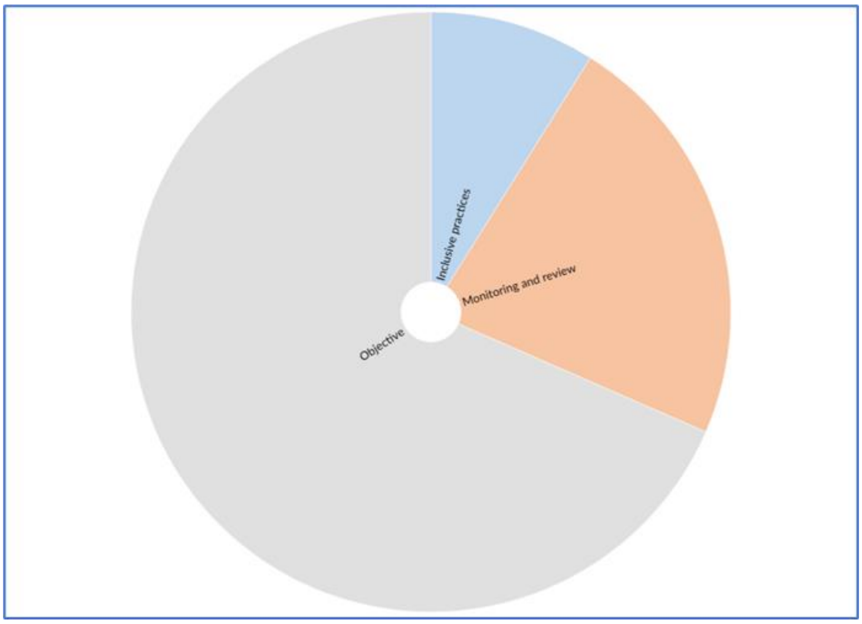
Communication timing, Inclusive communication, Information (misre-)presentation, Information relevance, Mode of communication

Price and value 3(c)



Benefit, Lifetime cost, Scope and limitation

Product outcome 3(d)



Inclusive practices, Monitoring and review, Product objective

While not referenced as often as sludge and predatory practices, built-in friction is an important component of consumer support issues (Figure 2 and Figure 3a, above). Built-in friction reflects whether practices tend to allow customers the time and scope to think through or reconsider financial products so that they can make informed decisions. This part of consumer support provides scope for carefully matching product characteristics with the customers' needs and circumstances, including (alternative) cost considerations.

Built-in friction can also serve as an extended window of opportunity for resolving issues around consumer literacy drawing on formal and informal sources of financial product advice and knowledge. For example, if well-explored, a 14-day cooling period (allowed in financial product contracts) may provide an opportunity to seek clarifications from customer support desks and specialised departments in the potential financial service provider. Customers can consult financial and/or legal advisers during this window to gain insights into the benefits and risks associated with the planned products and contract terms. Customers may also draw on peer-to-peer learning and financial literacy opportunities by asking people within their informal networks about experiences with a product and its provider. Rich and contextual information from family and friends, as well as social media connections, can complement customers' basic financial literacy and specific product knowledge hence it might offer scope for informed decisions.

Sludge and predatory practices are on the other side of built-in friction. Sludge occurs when customers undergo tedious and undue processes to end contracts or switch products. It may exist in the form of subtle customer support practices and requirements that frustrate consumers' efforts at resolving issues around products or ending contracts. Sludge practices may drive up cost in financial and non-financial terms, for example, through drawn out processes, which might cost the customer additional money, time loss and fatigue.

Issues recalled in the observed FOS complaints, investigations and decisions include not only aspects of sludge related to tedious processes but also those centred around predatory practices including perceived pressure mounted on customers to purchase financial products. This is in addition to third-party activities (by brokers), which tend to frustrate consumers as they are often considered unclear, sometimes tied to undisclosed extra costs. The prominent recall of sludge and predatory practices as an aspect of consumer support issues is relatable considering that the component also derives from and contributes to the key issues of consumer understanding and lifetime cost. For example, issues considered in predatory practices include evidence that the customer has been pressured into buying products that they may not need, especially if sold at a high cost and in vulnerable circumstances.

Predatory practices also derive from how information about the relationship between brokers and lenders is presented to customers. For example, predatory practices may derive from whether roles, relationships and interests of lenders and brokers are clearly and completely disclosed, if at all known to the customer, or whether it is a secret. In this case, predatory practices derive from consumer understanding issues. In a similar vein, complaints, investigations and decisions consider the use of the discriminatory commission model and whether the commission set is clear and commensurate with the broker's efforts in facilitating the credit product (price and value, specifically related to lifetime cost). The links between the key components of consumer outcomes are elaborated in the description of clusters presented below (Figure 4).

The recurrence of the lifetime cost problem in the FOS cases reflects broader challenges of high cost of credit, which the FCA recognises and has taken steps to address. For example, an FCA’s report (Financial Conduct Authority, 2019) recognises the rising cost of motor finance in the UK, including the adverse role of the discretionary commission model. Under this model, also known as discretionary commission arrangements (DCA), lenders reward brokers by allowing them (brokers) to set interest rates at their own discretion. Given this wide discretion, interest rates tend to be high and tend not be in accordance with the work brokers do in facilitating credit. Instead, the interest rates set tend to explore and exploit the circumstances of the borrower. Accordingly, the FCA points to the potentially significant harm that the high cost of motor finance may cause consumers.

In a related effort, the FCA instituted some measures to address the high cost of credit in motor finance, including a measure that lenders should provide a temporary freeze on repayment for customers who faced financial difficulties caused by the COVID-19 pandemic (Financial Conduct Authority, 2020). In 2024, the FCA embarked on an initiative to review and hold stakeholder consultations on the high cost of motor finance and related practices, particularly DCA (Financial Conduct Authority, 2024). This follows the wide attention these issues had received in the financial services sector, and indeed, the impact of high-cost credit on consumers' financial wellbeing.

6.2 Co-occurrence and links between consumer outcomes issues

Clustering of concepts indicates elements of consumer outcomes that tend to co-occur (see Figure 4). The groups and connections offer simple and helpful insights into how key issues co-occur and potentially re-force each other. Key elements like lifetime cost and concerns about potential predatory lending practices co-occur prominently in the complaints and investigations (Cluster 4). Complaints about unfair practices including non-disclosures; unclear and (half) secrets (information misre-/presentation) around commissions are the most contentious issues linked to predatory lending practices (perceived and/or actual), which in turn drive up cost. Customers often consider these practices unclear and unfair, which explains the recurrence of predatory and related sludge (pressured sales) as one of the most recalled issues relevant to consumer outcomes in the FOS cases. The role of predatory practices is also shown in the impact diagram presented below (Figure 5b).

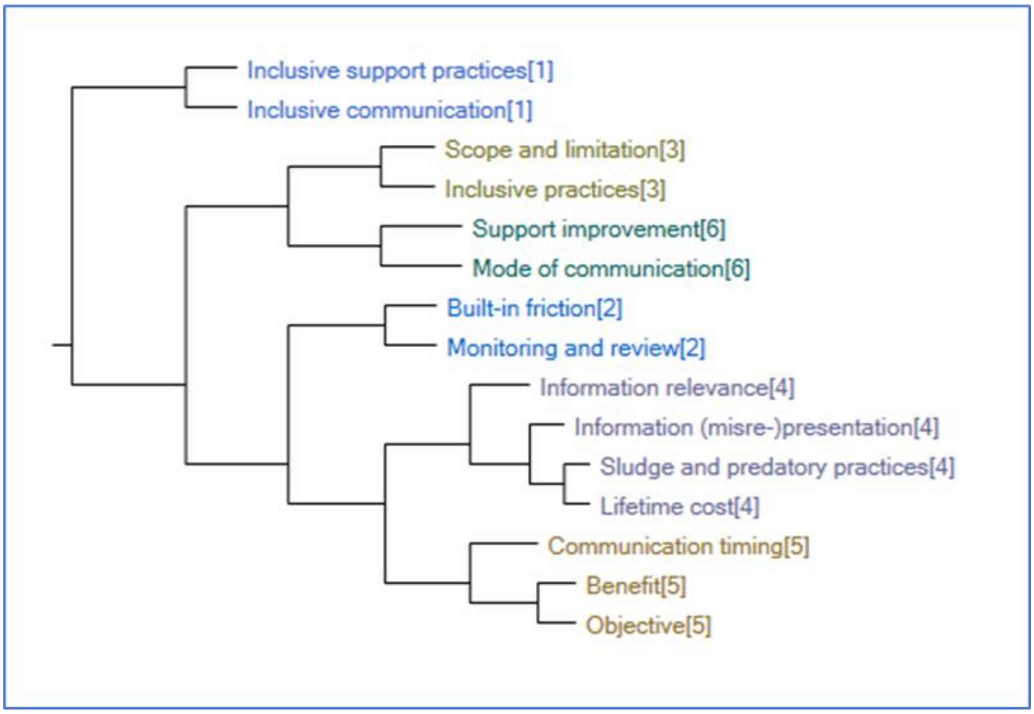


Figure 4, Clustering of themes, based on related recurring words/concepts

The co-occurrence of benefit (price and value) and customers' product objective (product outcomes) is expected as the former is one of the mechanisms for realising the latter (Cluster 5). The close link of objectives and benefits with aspects of consumer understanding (information and communication-related components) and consumer support derives from, and underscores, the latter as a set of intermediate processes and tools for explaining and building relationship around product objectives and value. Relevant information in documented contracts and follow-up communications are key to realising good product outcomes. Where such processes and tools are lacking, or contentious, contractual conflicts may arise. The prominence of consumer understanding as one of the most recalled issues evidences these interactions.

Built-in friction, and monitoring and review are both process-check mechanisms. While built-in friction serves as an important early-stage procedure to allow customers to think through and possibly change their minds about products and contracts, the monitoring and review component serves as a check to realign product and contract implementation with customers' changing circumstances. The occurrence of inclusion components points to the intersection of processes and practices that adjust consumer understanding (inclusive communication) and customer support to circumstances and contexts.

6.3 The role of selected themes: Interaction between thematic issues

The co-occurrence and links between key issues can be extended to elaborate how they might shape consumer experience and outcomes (Figure 5a-c). In Figure 5a, information presentation is the focus of the impact diagram. While information (misre)presentation can be shaped by built-in friction, for example, through allowing more time and consultation for product and contract clarifications, the former plays a key role in shaping related consumer outcomes.

On the adverse side, when products and terms of contracts, including disclosures of existing interests and relationships, are misrepresented, consumers stand the risk of harm in the form of product misalignment with objectives. This poses the risk of reducing consumer benefit as misaligned objectives mean missed product expectations and adverse consumer experience.

Benefit reduction can also derive from consumers' losses through hidden costs associated with sludge and predatory practices, which are directly linked to information misrepresentation and poor understanding of financial products, especially under perceived or actual pressured sales practices, as aggrieved customers frequently claim in the FOS complaints. When financial services providers fail to fully disclose or clarify the nature and degree of risk associated with a product— in the case of brokers' involvement, not (fully) disclosing the extra cost that applies— then customer notification resembles the practice of using caveat emptor. This is a form of "buyer beware" notice that leaves the customer to do the additional due diligence needed to understand the signalled risks, if notified at all. While this approach serves as a basic form of indication of potential risks, it is insufficient to address circumstances where the buyer is in a vulnerable situation. This may be, for example, when a potential borrower needs credit but possesses limited product knowledge and financial literacy and, at the same time, exposed to pressured sales. Under this condition, aggressive sales practices and fear of losing out if a decision to purchase the product is delayed might lead the consumer to wrong product choices.

A business model that priorities customer value would more likely be oriented towards practices that discharge the fiduciary responsibility that the provider owes the customer, including going beyond caveat to offering tailored support that helps to avert and/or mitigate the risk of using a financial product and any associated third-party services. The issue of information presentation is crucial to business relationship with vulnerable consumers who may require additional support with clarifications about financial product, adjustment to special circumstances and needs, as well as arrangements and processes that are free of hidden information, hidden costs, tedious opt-out requirements, pressured sales and related predatory practices. Where adverse customer support and poor product understanding apply to vulnerable customers, these contradict inclusive support practices. The link between information misrepresentation and inclusive support practices points to the need to integrate personalised financial literacy and context-adjusted consumer support programmes into financial products. Personalised and context-adjusted support offers scope for enhancing the capabilities of consumers to identify, understand, use and benefit from financial products, with low likelihood of escalated complaints that require third-party adjudication.

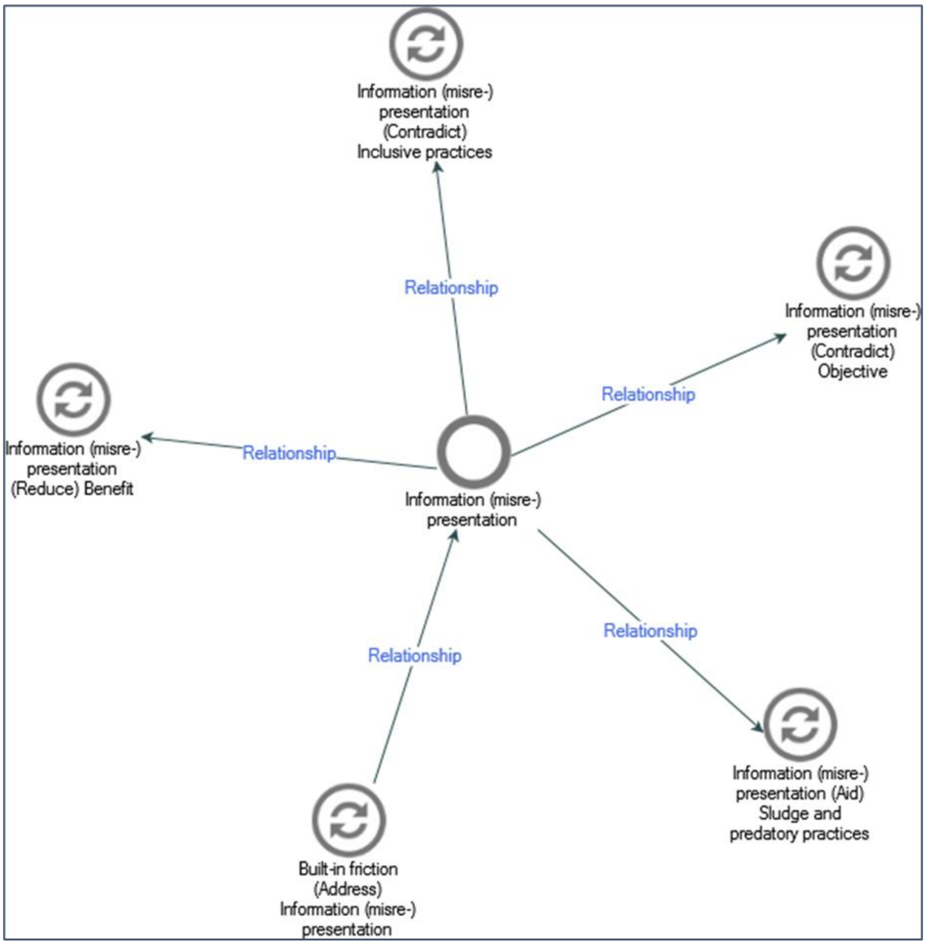


Figure 5 (a), Focus sub-theme (outcome): information (misre-)presentation.

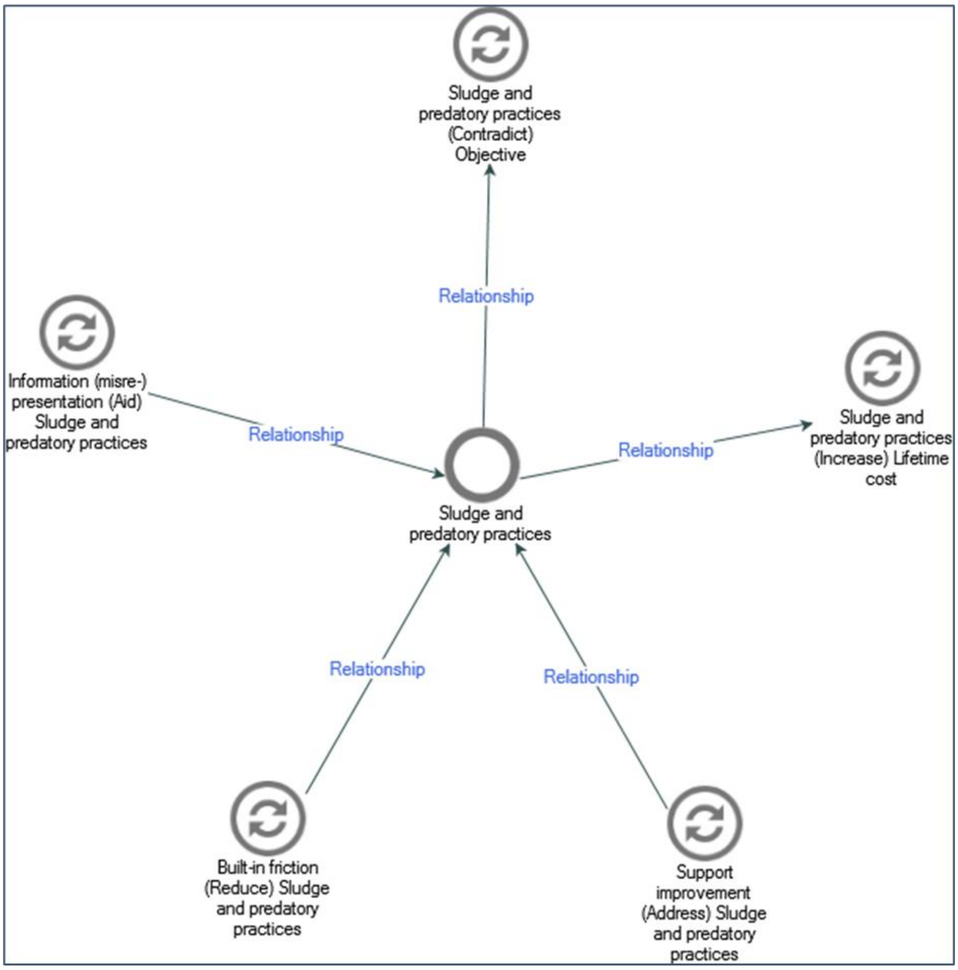


Figure 5b, Focus sub-theme (outcome): sludge and predatory practices

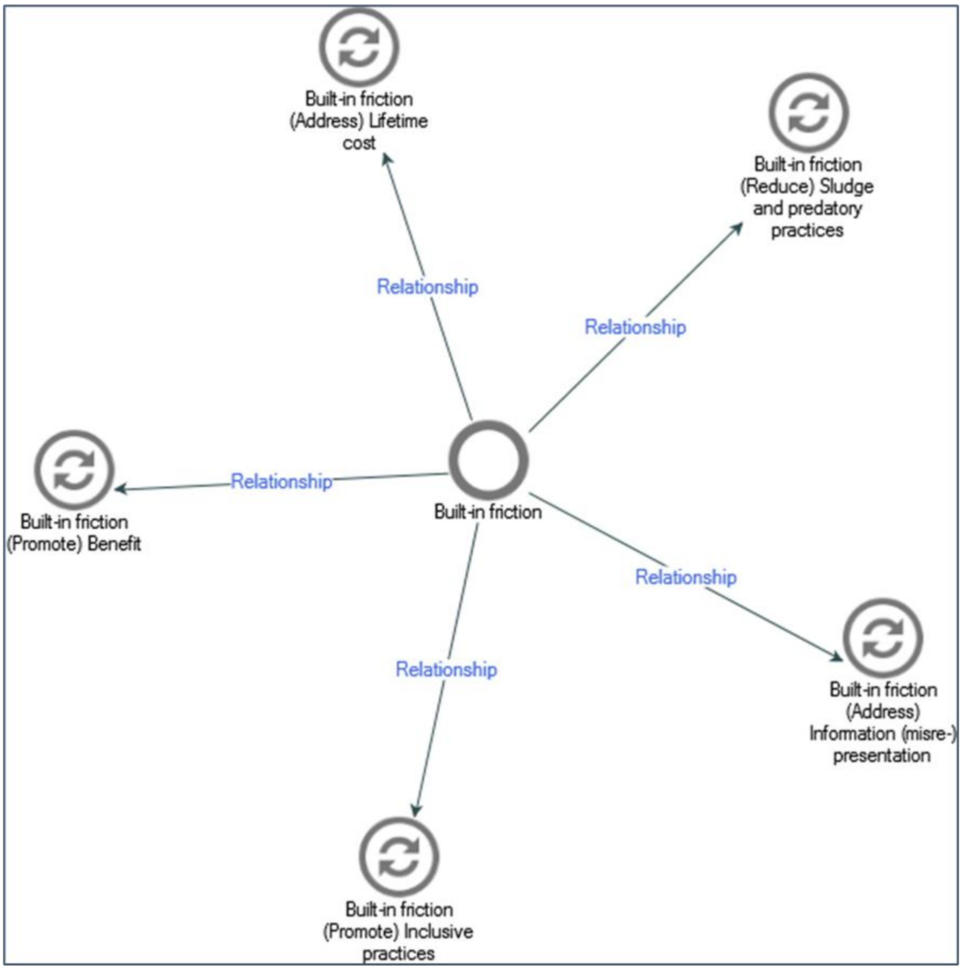


Figure 5c, Focus sub-theme (outcome): Built-in friction

7. Conclusions: Making Sense of Key Questions around Consumers as Innovators in Financial Services

In this concluding section, we summarise our responses to the three questions set out in Section 2 (above) of this paper. As an overview from the Ombudsman complaints resolutions, we gain a view of restrictions on consumer adaptation and innovation. Additionally, we gain a view of the extension of regulatory compliance into some consumer activities, notably of the critical role for financial services providers to ensure consumer understanding of products, especially in documents that describe a product and its contractual terms and conditions. This critical dimension is also governed by GDPR, setting it apart from other channels focused specifically on marketing and sales.

7.1 In which ways do Financial Services companies, as they develop and market financial services products, imply that customers, consumers, and end-users become innovators too as they use financial products and services?

Our observation of the customer journey in financial products and services shows a model in which products are designed, developed and delivered to a target market segment whose characteristics are deemed to match offers. This tends to complicate consumer understanding of the tightly pre-developed products and services. Our observed recurrence of consumer understanding issues in the FOS complaints and investigations resonates with a related study of the UK financial services sector, with focus on savings. It was found that products predefined and targeted at a mass segment of consumers tend to confuse consumers, often contributing to consumers' unfamiliarity with and lack of confidence in products, which results in poor savings product choices (Costanzo and Ashton, 2006).

While this approach is not a problem in itself, the flexibility allowed in the product use phase contributes to the extent to which customers are invited to participate as active consumers in the product cycle, or are more constrained, cast into a passive 'user' role. The financial service sector is a strictly formal one, subject to rules and standards, considering the nature of its products and services. The development and delivery of specific products, which are highly bundled from scratch, leave little room for consumers to make changes independently adapted to their preferences and circumstances.

One mechanism for enforcing the limited scope for adaptive product use is contract. Unlike physical and off-the-shelf products that consumers may purchase, use and adapt as needed, financial products are in most cases still tied to the producers/providers. This means that customers must continue to maintain agreed terms of use that restrict the extent to which the original product can be modified. In some cases, for example, hire purchase and residential mortgage, the product technically still belongs to the financial services provider/lender until full payment is made. Considering that the current use is a form of rented ownership (renting with the possibility of owning in future subject to contract terms or perpetual rental) effecting major changes to property or related products is constrained.

The expectations that the original product can be resold to a different buyer in pre-designed market segments also means limited scope for significant adaptive use. In residential mortgage, for example, while adaptation from an owner-occupied use to a rental type is a form of innovative measure to align product with changing consumer preferences, circumstances and contexts, this action must be allowed by the financial services provider. Permission may be, for example, through the issuance of consent to lease (CTL), which has a restricted number of requests and length of use, otherwise it is deemed a breach of contract. Indeed, part of the contentions in the FOS complaints and investigations concerns whether customers have been treated fairly if they are unable to switch product objectives and uses, for example, from residential to rental homes or from holiday club membership to real estate ownership. Accordingly, the level of consumer innovation is not necessarily only limited by customers' knowledge of new or possible uses, but also the extent to which the instruments that moderate provider-user relationship permit user-/consumer-led innovation.

7.2 What do producers and consumers tend to exchange additional to a product/service and payment?

On what financial services providers and consumers exchange apart from product and money, one key stream of exchange is the information and communication element of the relationship as observed in the FOS cases. Throughout the customer journey, information exchange forms part of the process, and can be thought about as preceding the exchange of products and payments. This covers the initial stages when product objectives are identified, when consumers' needs are matched and, if successful, up to the later stages of product use and upkeep of the relationship. Considering the tight design of existing products and services to fit predetermined needs and consumer segments, the current framing and conduct of exchange is primarily oriented towards predesigned products and services, with less information and knowledge production for innovation process flowing from the consumer or user. Consumers do play a role in communicating relevant information required to provide customer support in the form of clarifications and treatment of issues related to how they can draw out value from products in ways that align with predefined and agreed objectives. This pattern is connected to the nature of product design and delivery discussed earlier.

Information flow from consumers to producers is more likely to generate appreciable knowledge that leads to product modification if the initial design and delivery models anticipate and permit or even reward the capability of consumers to effect changes to the original product design and use. Since the formal design and delivery models of financial products tend to leave less scope for active consumption and product tinkering, which may even be penalised, information flow is highly restricted to consumer observations of how they may be supported to use pre-designed products, and how they understand the promise of support as part of a provider's overall product or service offer. Indeed, empirical findings from the US, related to the UK market context on which our study is based, shows that a significant part of innovation in retail banking products and services was already developed and used in some form by individual users through self-service. These user-developed innovations formed a precursor to more sophisticated products designed by financial services providers and delivered to mass consumer market segments (Oliveira and Von Hippel, 2011).

Considering that innovation occurs mainly through learning by doing, using, interacting and adapting, which tends to be restricted in formal financial services, knowledge flow from actual innovative consumers to producers, beyond formal product feedback, is limited under the current models of product design and delivery. Opening up business model innovation in financial services can afford firms ample opportunity to develop products and services outside-in, to complement their in-house expert knowledge base and innovation. This entails not only the unbundling of the innovation process through the engagement of external service providers such as suppliers/consultants, but also a model that allows the integration of consumers as key actors in innovation process (Fasnacht, 2009). As consumers become more sophisticated — for example, through the rapid digital developments that offer them opportunities to acquire product knowledge, including from peer-to-peer learning, and through learning by doing/using products — they are better equipped to share knowledge that can help to improve financial products and services. This is important as consumers understand their own situations better, which motivates them to tinker around the original product features and piece items together to address their evolving needs and circumstances.

7.3 What capabilities and skills do consumers need so that they can draw out the value of their financial services products and services?

Drawing out more value from financial products and services requires customers' capabilities around product knowledge in line with their objectives, contexts and changing circumstances. The current tight design and delivery in traditional financial services mean that integrating continuous consumer literacy into financial product can help to enhance product knowledge and use. Where customers identify new uses, which may vary from the original design, capabilities building goes beyond product knowledge; it extends to incorporating aspects of contracts and compliance. The extent to which consumers can adjust or switch from original product ideas and designs depends on the degree of flexibility permissible in contracts. Accordingly, complementary capabilities building on the side of the financial services providers, especially in terms of flexible contract terms, can help to improve the scope for consumer innovation, allowing as much as possible adaptive uses and information change that benefit all parties fairly. This means creating ample opportunity for consumer-driven innovative practices that prioritise consumer circumstances, contexts and experiences.

One point to note is the role of industry regulators in this process. The tight design and somewhat consumer innovation-averse nature of financial products and services can be partly attributed to strict regulatory and compliance requirements in the financial services sector, so following the discussion of market channel and transvective, being a process of speculation and marketing to consumers. This had meant that, faced with the challenge of strict regulatory compliance and/or innovation, financial services providers, especially in a traditional sense, tend to prefer to err on the side of caution thereby following the part of compliance to protect investors interest and reduce costly penalties. Therefore, consumer innovation in financial services can benefit from regulatory changes that offer scope for greater flexibility and more active consumer innovation, which in terms of the market channel and transvective, would involve postponement, engagement, and consumer insight. The current regulatory channels for incorporating consumer insights tend to be reactive, mainly through forums that focus on complaints when things might have gone wrong and might not have been resolved. The FCA Consumer Duty Guidance offers some scope for consumer-focused innovation, especially through the dimension of consumer understanding.

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