Vulnerable Customers

Ensuring that no man is left behind

Drivers

- The number of customers identifying as vulnerable is increasing due to tough economic times and the impact of the COVID 19 pandemic
- There is increased regulator scrutiny combined with public pressure on financial services firms to do the right thing, even when no one is watching
- Looking after vulnerable customers is not just a compliance exercise, it's a business imperative

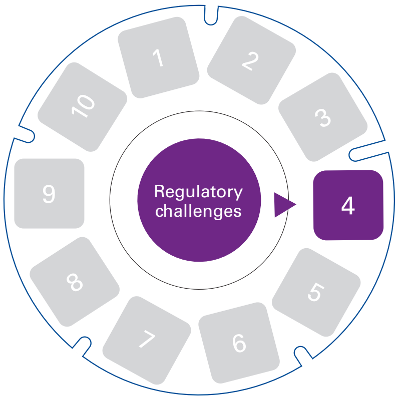
Michelle Dubois
Senior Manager
Regulatory Centre of Excellence

The concept of the **vulnerable customer** is receiving increasing focus in South Africa in recent times, particularly as we struggle through difficult economic times and fight the COVID 19 pandemic. The Ombudsman for Banking Services in South Africa has stated that "financial service providers are expected to provide consumers with appropriate products and services and a level of care that has due regard to the capabilities of the consumers in question. The level of care that would be deemed appropriate for vulnerable consumers may be different from that which would suffice for other consumers. It is crucial that financial firms acknowledge this and implement processes and procedures to cater for the needs of vulnerable consumers, as these customers may face a significant risk of harm".

The term vulnerable customer was first defined by the UK Financial Conduct Authority ("FCA") in 2015, as *"someone who, due to their personal circumstances, is especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care."* This definition has two elements to it that we should examine further to ensure a complete understanding of the concept of the vulnerable customer - the first being the customers personal circumstances that may result in them being prone to a greater degree of harm than the average customer; and the second element being the onus that is placed on the financial institution to treat the vulnerable customer fairly and with due consideration of their circumstances.

Identifying the vulnerable customer

This brings me to question how we identify vulnerable customers and their needs. Defining vulnerable customers is a fluid concept, particularly at a time where this category of customer has expanded dramatically as a result of not only the COVID pandemic, but also as a result of globally constrained economic circumstances. An example which is particularly relevant, at this time when many financial institutions are offering pandemic relief is premium holidays. By their very definition, the customers making use of these offers are vulnerable. Do these customers fully understand the long term financial implications of taking a premium holiday and the implication on the total cost of credit? Is this a short term solution that might come back to bite them later on? More importantly is this a solution which treats the vulnerable customer fairly and gives them a sustainable financial solution?



In the same way, we must consider the impact of rising unemployment; short term income reduction in numerous sectors as various stages of lockdown are implemented; and the impact of illness and economic uncertainty. It might be a short-term concern or it may be ongoing, so our existing parameters as financial institutions need to take cognisance of this.

The onus on financial services firms

Taking the guidance from the FCA one step further, the FCA explains further in their definition that, "vulnerable consumers may be more likely to experience harm. In many cases, this risk of harm may not develop into actual harm. But if it does, the impact on vulnerable consumers is likely to be greater than for other consumers."

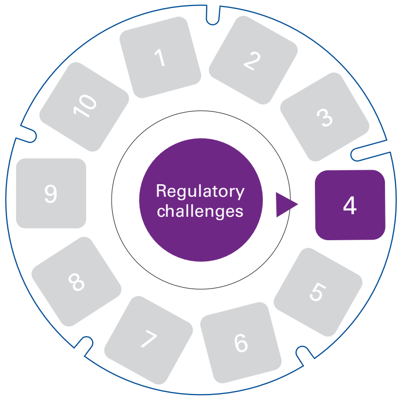
That's a big "if" and raises the question to what lengths should a financial services firm go to, to ensure that vulnerable customers are identified, protected and ultimately treated fairly? What increased responsibility or onus lies with the financial institution to consider or ensure appropriate outcomes for the vulnerable customer? The FCA, which is closely followed by other jurisdictions, and in particular our own, is increasingly indicating that they are looking for financial institutions to show that their products and services remain relevant for their customers, even in changing circumstances.

The second draft of the Conduct of Financial Institutions Bill ("the Bill") released in 2020 makes it clear that when providing financial products and financial services a financial institution must ensure that the products and services are— (a) appropriate for targeted or impacted financial customers; (b) provided in a manner that is as objective as possible; and (c) provided in a manner that supports the delivery of appropriate financial products and financial instruments to those financial customers.

The Bill goes further to say that a financial institution must ensure that its financial customers are provided with financial products and financial services, as the case may be, that perform as that institution has led its financial customers to expect, through the information, representations and advertising provided by or on behalf of the institution to those financial customers. Although not expressly mentioning the vulnerable customer it is clear that the regulator would like to see a more defined move away from a product centric approach to one that puts the customer's needs first.

The COVID pandemic has provided an example of just how critical it is to ensure that products remain relevant. Business interruption cover gave many clients a false sense of security (rightly or wrongly), believing that in the event of interruption to their business they would be covered. No one could have reasonably envisioned the extent of the current pandemic and not all business interruption policies included circumstances such as these in their contracts, leading to disillusioned customers and a social media frenzy. Ultimately in order to treat customers fairly under the circumstances we have to ask the uncomfortable question: are we prejudicing vulnerable customers by strictly relying on the legal provisions in their contracts?

Another critical component of ensuring appropriate outcomes for customers, is making sure that customers, especially those who are vulnerable, receive ongoing product communication. I have to wonder how many customers who were retrenched as a result of the pandemic relied on, or knew to rely on, their credit life insurance to meet their mortgage payments? Were they aware that this was an option that was available to them? When they signed for their home loan did they understand that this cover was included in the package?



The strategic advantage of doing the right thing

And therein lies the upside, its not only about the warm and fuzzy feeling of doing the right thing. I have no doubt that a customer who is approached by his bank after being retrenched with an offer of a claim for credit life cover will be a customer for life. That is the strategic imperative of treating your customers fairly and that is where the importance of data comes in – knowing who your vulnerable customers are and what risks they face. Financial institutions have the numbers they just need to crunch them wisely. Lapse rates, repudiation stats, claims ratios, they all tell the story and identify your Conduct risks. High repudiation stats may indicate that customers are not informed about circumstances under which they may claim, they may have unrealistic expectations of the product performance due to misselling. On the other hand a product with very low claim rates, that happens to be sold as a bundled product may indicate that customers are not even aware that they have this benefit.

The 2019 Australian Royal Commission investigation into financial sector misconduct gave increased focus to the concept of vulnerable customers. This report highlights "that asymmetry of knowledge and power will always be present. Accordingly, there will always be a clear need for disadvantaged consumers to be able to access financial and legal assistance in order to be able to deal with disputes with financial services entities with some chance of equality." The challenge therefore is for financial institutions to make sure that no man is left behind.

Key actions

— Information asymmetry is a major Conduct risk. This means that the financial institution has the advantage of having specialist knowledge about the product they are marketing, while the customer only has the knowledge they are given by the financial institution. To mitigate this risk, make sure that your customers have as much information as they need to make informed decisions

— Proactively manage the data you have and use this to identify Conduct risks where vulnerable customers may have been at risk

— Embrace a customer centric approach to business. Put the customer at the heart of everything you do and the product will sell itself


CUSTOMER
journey
Awareness
Consideration
Decision
Retention
Advocacy