

## **Alert** | Financial Regulatory & Compliance



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### **FCA Takes Next Step Towards a UK Consumer Duty: An Update for Regulated Businesses**

In December 2021, the UK Financial Conduct Authority (FCA) published a **consultation** to set a higher standard of consumer protection in retail financial markets, an endeavor which began in July 2018. At the core of the proposed new rules is a new Principle for Businesses: “*A firm must act to deliver good outcomes for retail customers*”. This is to be supported by detailed rules and guidance, also under consultation. The scope of these proposed provisions is wide-reaching, covering both those who deal directly with retail customers and those who form part of relevant supply chains. Importantly, the FCA has decided that (at least for now) it will not allow customers to bring a civil claim for an alleged breach of these rules. However, noncompliance with the rules would risk regulatory action. The FCA expects to make any new rules by 31 July 2022, which likely would come into force in 2023.

#### **Background**

The FCA has published a second consultation in respect of its proposed Consumer Duty (the Duty), refining the original proposals. The Duty is in fact a range of proposed provisions whose purpose is to ensure that those regulated businesses dealing with retail customers put those individuals and businesses and their interests at the heart of all decision making, from product design through to sales and administration. This is an important and flagship reform for the FCA; it sits alongside the guidance that the FCA has already issued about how regulated businesses should treat vulnerable customers. The FCA intends the Duty once implemented to be relevant throughout the “*regulatory lifecycle*”, including in respect of Authorisations, Supervision and Enforcement. The COVID-19 pandemic and the damage it has

caused to the financial health of parts of the population make this work feel timely even if in truth much of it has been in the pipeline for some time.

There has already been a considerable amount of discussion and debate around the Duty. In this GT Alert we focus on seven key takeaways for regulated businesses.

### **1. As currently drafted, to whom does the Duty apply?**

As it currently stands, the Duty would apply to all FCA-authorized firms, payments services firms and issuers of electronic money. It would apply both to regulated activity and to any non-regulated activities ancillary to regulated activities. For example, product design.

Importantly, regulated businesses would be captured by the Duty even if they do not have a direct relationship with the end client(s). The FCA proposes that the Duty apply to all such businesses with a material influence over the features, communications or distribution of a product or service in the “*supply chain*” to retail financial consumers.

### **2. Whom would the Duty protect?**

The Duty is intended to benefit retail customers (therefore excluding professional clients and eligible counterparties). This means natural persons but also small- and medium-sized enterprises would be protected. However, the FCA now proposes an additional level of nuance in the scope of the Duty, in that its application would track the scope of its other rules that also apply to the product or activity at issue. For example, financial promotions made to a properly certified high-net-worth individual that would fall outside the scope of FCA regulation would also be outside the scope of the Duty. However, other interactions with a high-net-worth individual (for example, investment advice) would not necessarily fall outside the Duty’s scope. Whilst this makes the scope more complex, it also avoids inconsistency.

The Duty is not intended to apply to historic activity but will apply to existing products held by customers from the date that it comes into force.

### **3. What is the current content of the Duty?**

The Duty is a range of proposed provisions, the center of which is a new Principle for Businesses: “*A firm must act to deliver good outcomes for retail customers*”. By proposing this as one of the Principles for Business – key tenets for all regulated activity that sit behind FCA decision making – the FCA is signaling how seriously it takes this standard of care.

The Principle’s intended application is structured around three rules: (i) a firm must act in good faith towards retail customers; (ii) avoid foreseeable harm to retail customers; and (iii) enable and support retail customers to pursue their financial objectives. To avoid the risk of firms fixating on process as distinct from outcomes, the FCA has abandoned its proposal that (ii) and (iii) be framed as an obligation to “take all reasonable steps”.

The Duty and the rules are bolstered by four outcomes: (i) products and services designed to meet the needs of consumers and sold to those whose needs they meet; (ii) the price of a product represents fair value; (iii) consumers have the understanding to make effective, timely and properly informed decisions; and (iv) consumer support that enables consumers to realise the benefits of products and to act in their own interest. These four outcomes are themselves based on more granular rules and guidance relating to each. We look at some examples below:

- In respect of the products and services outcome, the FCA proposes distinct requirements for “manufacturers” and “distributors” of products. For example, product manufacturers will be required to identify a target market whose needs and characteristics (including vulnerabilities) are met by the product. They will also be required to operate a formal approval process and review the product regularly. Where more than one firm is involved in manufacturing, firms will be required to clearly identify their own responsibilities and align these with the other firms involved. Examples of the requirements on distributors include getting information from manufacturers to understand the product and the intended distribution strategy.
- As to the price and value outcome, some respondents to the consultation were concerned by the FCA getting involved in pricing and the assessment of “*value for money*”. In response, the FCA has sought to clarify that it is not seeking to introduce hard limits on the level of margin firms can make. Its plan is instead to introduce rules that set out the factors firms must consider when assessing fair value both initially and on an ongoing basis. These will include the nature of the product, its quality, and characteristics of vulnerability in the target market. As with the “*products and services*” outcome, the rules will vary depending on the role that the firm plays in the “*supply chain*”. Product manufacturers will have to consider fair value at the design phase, whereas distributors will need to consider the fairness of their own charges and potentially, if they are the last firm in the supply chain, whether or not the overall pricing proposition is fair. Distributors will have to satisfy themselves as to the fair value outcome before they distribute any financial product.

#### **4. Will there be a private right of action following an alleged breach of the Duty?**

Much of the discussion around the Duty historically has focused on whether it would be desirable to allow customers to bring civil proceedings following an alleged breach of the Duty. As the FCA says, this issue has proven polarizing, with consumer representatives favouring the proposal and industry representatives opposing it. As it stands, the FCA has decided not to include a private right of action but has said it will keep the position under review and monitor how effectively the Duty is embedded. In taking this decision, the FCA was influenced by the existing availability of the Financial Ombudsman Service as a free, consumer-focused dispute resolution mechanism.

#### **5. What are the expectations on a firm’s management?**

The FCA expects a firm’s board or management to regularly assess information on customer outcomes. There is also an expectation that the board/management assess compliance with the Duty in the round at least annually. This cannot be a tokenistic exercise – the FCA anticipates it will be based on evidence; for example, statistics on good or bad outcomes and steps taken to mitigate areas of weakness. The FCA intends to let firms decide for themselves what kinds of information they need to collect in order to fulfil these requirements.

Senior management is responsible for and therefore at risk of regulatory action or censure if the firm breaches the Duty. However, in addition, the FCA proposes to enhance the existing the Code of Conduct Rules (applicable to management and most firm employees) so that there is an individual responsibility for delivering good outcomes for retail customers. This responsibility will become more onerous the more senior the role. A breach of the Code can result not only in disciplinary sanction by the firm but also potentially form the basis of regulatory action.

## 6. What is the FCA's schedule for implementation?

The current consultation closes on 15 February 2022. The FCA currently proposes that firms be given until 30 April 2023 by way of an implementation period.

## 7. What should firms be doing now?

Whilst the consultation period has proven long, the Duty will be implemented and the FCA intends it to be a catalyst for significant change. Even if they are not inclined to respond to the consultation, firms impacted by the Duty should start considering what they may need to do to meet the new standards. Much like they may already have done to meet the FCA's expectations around vulnerable customers, firms should consider first the markets in which they operate (directly or indirectly), the nature of the products and services that they offer and where areas of tension with the Duty might arise. They should also start to consider what kind of information they may need to start to comply with the Duty. For example, some firms may not have a grasp on their target markets, customer outcomes and sources of complaints, and gathering this data takes time.

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