

CMS Financial Services Regulation Bitesize Briefings: **Consumer Duty**

What does it mean for wholesale firms?



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6 June 2023



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In this session we are going to cover:

- 01 Key elements for wholesale firms
- 02 Scoping and assessing material influence
- 03 Implementation in the wholesale sector
- 04 Best practice and next steps



Section 01
**Key elements for
wholesale firms**

Consumer Duty – key elements for wholesale firms

- Not a “one-line” duty but a “package of measures”
- Applies proportionately:
 - Firm’s role +
 - Nature of product/service+
 - Characteristics of consumers
- Focus on outcomes, not prescribed steps
- Underpinned by standard of reasonableness
- Applies irrespective of whether have a direct relationship with retail customers



Consumer Principle
A firm must act to deliver **good outcomes** for retail customers



Cross-cutting Rules
Firms must:

1. Act in **good faith** towards retail customers
2. Avoid causing **foreseeable harm** to retail customers
3. Enable and support retail customers to pursue their **financial objectives**



Four Outcomes

1. <u>Products and services</u>	3. Consumer understanding
2. <u>Price and value</u>	4. Consumer support

- Prin 6 & Prin 7 disapplied where Duty applies
- Will not apply to unregulated business unless “ancillary” to regulated activities
- Definition of “retail” aligned to sector sourcebooks, with extended scope for product distribution chains and also pension schemes

COCON

- New Individual Conduct Rule 6 (all staff) – reasonableness embedded
- Scope aligned to Consumer Principle



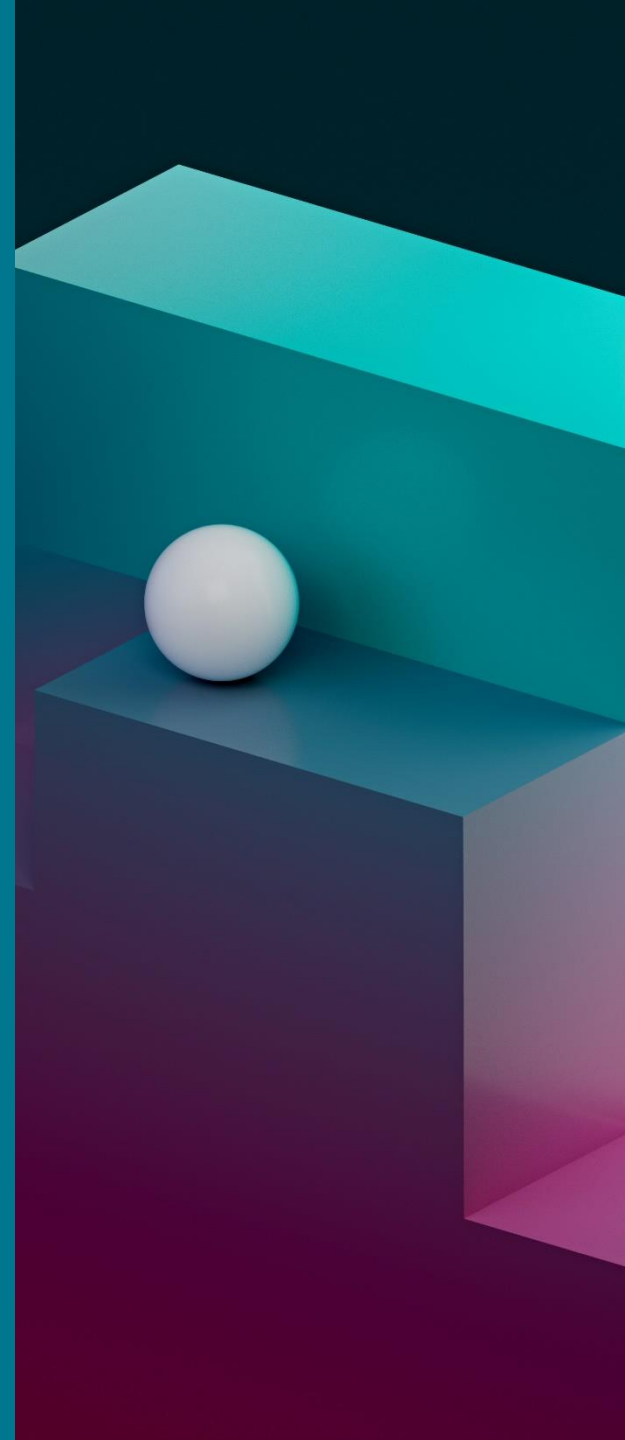
It is important that all firms that can determine or materially influence retail customer outcomes should take responsibility for their actions, regardless where they sit in the distribution chain.

[However, t]he impact of the Duty on wholesale firms to which it applies may be less marked than some respondents suggested. The Duty applies only to the extent that a firm is responsible for determining or materially influencing retail customer outcomes.

And, where it applies, we are clarifying that obligations on firms must be interpreted proportionately, in a manner that reflects the firm's role in the distribution chain and its ability to influence retail customer outcomes.

In addition, as noted above, where a firm is already subject to rules on product design or the assessment of value, complying with these rules will also satisfy relevant parts of the Duty.”

FCA PS22/9





Section 02
**Scoping and assessing
material influence**

Scoping (1/2)

What is potentially in or out?

What?

“Retail market business”

- Includes **regulated activities and ancillary activities**, and certain activities in relation to **payment services and electronic money**...
- ... of a firm in a **distribution chain**
- ... involving a “**retail customer**”

Key exemptions for wholesale firms

- Wholesale markets exemption
- Non-retail financial instruments
- Primary markets activities
- Benchmark administration
- Certain insurance activities
 - Certain large risks
 - Group policies

Who?

“Retail customers”

- Follows scope of sectoral sourcebooks
 - **BCOBS** – “banking customer” or “prospective banking customer”
 - **ICOBS** – “policyholder” or “prospective policyholder”
 - **COBS** – retail clients
- **Funds** – end investors (except professional clients)
- In relation to any other activities – a “customer”
- **Distribution chains** – includes end retail customer, even if not a direct client
 - Subject to “material influence” test
- Activities in relation to **occupational pension schemes** – includes beneficiaries in relation to investments held in scheme

Where?

In practice, the Duty can capture:

- Products sold to UK and non-UK customers; and
- Activities of UK firms and branches...
- ... as well as activities of non-UK branches involving UK customers

Scoping (2/2)

Assessing material influence in distribution chains

“Material influence test”

Where a firm is operating in a distribution chain, the Duty only applies to the extent that the firm is responsible for “determining or materially influencing retail customer outcomes”

This will be the case where firms have material influence over:

- Design or operation of retail products or services, including price and value
- Distribution of retail products or services
- Preparing and approving communications issued to retail customers
- Engaging in customer support

FCA guidance on the test

- **Operating within a mandate determined by another firm in the chain** – e.g. the Duty would not apply to a portfolio manager whose role is limited to managing assets under the mandate of a professional client and the client is independent of the manager
- **Factual information** – does not apply if role limited to providing factual information to support the work of another firm in the chain
- **Investment banks** – an investment bank that designs a structured product for sale to retail customers would be in scope but investment banks providing wholesale instruments as component parts of a product created by a third-party firm would not

Applying the test in practice

Areas to consider...

- Wrapped products – e.g. life policies that wrap a derivative/strategy or another wholesale product (e.g. a structured note)
- Secondary market activities
- Co-manufacturing arrangements

Will there be more guidance?

- Industry guidance – e.g. ISLA paper on securities lending, trade association WG discussions
- Potential FCA Dear CEO Letter?



Section 03
**Implementation in the
wholesale sector**

Implementation – what are the areas of focus?

Working out what “in scope” means in practice ...



What is the standard required? *The rules are to be interpreted in accordance with the standard that could reasonably be expected of a prudent firm carrying on the same activity in relation to the same product and taking appropriate account of the needs and characteristics of retail customers... PRIN 2A.1.6 G*



Overriding principle of proportionality. *The Consumer Duty applies proportionately. We would generally expect firms with a direct relationship with the customer to have greatest responsibility under the Consumer Duty... FCA CP21/36*

Areas of focus for wholesale firms in recent months...

Products and services	Price and value	Consumer understanding	Customer support
<ul style="list-style-type: none">• Co-manufacturing arrangements• Reviewing/uplifting product governance frameworks• Reviewing distribution chains• Reviewing/uplifting management information (MI)	<ul style="list-style-type: none">• Defining fair value• Formalising benchmarking against similar products• Manufacturer/distributor information exchange – EMT• Learnings from FCA review of fair value frameworks	<ul style="list-style-type: none">• Identifying all end retail customer-facing materials (if any)• To test or not to test?• Prospectuses and other regulatory documents• Disagreements between firms and with non-FCA entities in chain?	<ul style="list-style-type: none">• Identifying all end retail customer touch points (if any)• Developing an approach to vulnerable customers• Due diligence/oversight of distributors – what is required?



Section 4
**Best practice
and next steps**

Effective implementation for 31 July 2023

What does good look like?

- Implementation plan considered and approved by Board by 31 October 2022 and thereafter
 - Live document
 - Ongoing reporting and review
- Scope and gap analysis completed
 - All decisions should be documented with rationale re material influence or not
- All 4 outcomes reviewed and actions documented
- Clear articulation of what good outcomes means for your customers
- Effective and timely exchange of information with distributors and other stakeholders
- Consumer Champion input
- Ongoing monitoring and testing and annual board assessment processes established
- Training and people strategies and policies
- Full audit trail of assigned tasks, what was done and by whom, what was noted, what changed, rationale for changes, evidence relied upon, risks identified, calibrated and mitigated

Any questions? Please contact us...



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