Consumer Duty - initial impressions

Tara Swaminathan, Solicitor, and Charlotte Gregory, Partner at Capital Law, consider the newly implemented Consumer Duty and its likely impact on the wealth management sector.

The Consumer Duty Act came into force on 31st July 2023 for all open products and services in the UK. Most firms will already have implemented Consumer Duty by now and will be discovering how it is changing their processes in practice. We anticipate many stakeholders will be well versed in those changes, particularly those who harness technology to deliver their offering.

Essentially, the FCA has introduced a new principle: Principle 12; Consumer Duty is the requirement of firms to 'deliver good outcomes for retail customers'.

Consumer Duty forms part of the FCA's strategy to raise consumer protection standards. In light of the complexity of services being provided and cost of living pressures, the FCA's view is that it is even more important that firms understand customer needs and how to support them.

The embedding of 'good outcomes for retail customers' is achieved by understanding the other elements that underpin Consumer Duty; the cross-cutting rules and the outcomes.

Cross-cutting rules of Consumer Duty

Firms must:

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

Four outcomes of Consumer Duty

The four outcomes that the FCA expects to see as part of a firm's implementation of the Duty are:

1. Product and service

This is about product and service design, ensuring they meet the needs, characteristics, and objectives of a specific target market.

Ask yourself:

- Does the product design meet the needs of the target market?
- Is the distribution strategy appropriate to meet those needs?
- Are regular reviews being carried out to ensure that this outcome is met on an ongoing basis?

2. Price and value

This outcome is focussed on ensuring that products and services provide fair value, with a reasonable relationship between the price that consumers pay and the benefit they receive.

Ask yourself:

- Is the customer receiving fair value from a product/service versus the benefits?
- Does a fair value assessment occur?
- Have benefits, limitations, fees, and charges of products/services over the lifetime of a customer relationship been considered?

3. Consumer understanding

This centres on communication; typically through verbal or written communication, such as marketing materials or customer-facing terms and conditions.

Ask yourself:

- Have you provided sufficient information to a customer at the right time, in an understandable way, throughout the customer journey?
- Does the communication equip consumers to make effective, timely and properly informed decisions about a product or service?

4. Consumer support

This outcome is focussed on the support being provided to consumers; to ensure your business is meeting your consumers' needs, throughout the lifecycle of a product or service.

Ask yourself:

- Have you provided customer support at all relevant times (pre- and post-sale/service)?
- Have the financial objectives been understood?
- Is customer support efficient and easy to navigate?
- How are vulnerable customers supported?

How do you know if Consumer Duty applies to your firm?

In essence, Consumer Duty will apply to all firms who distribute or manufacture products and/or services to retail customers - establishing which customers fall into this definition for Principle 12 purposes is a process in itself. Even if your end-customer is not a retail client, that does not automatically disapply Consumer Duty to your products/services. It is also important to be aware that it is impossible to take a blanket approach, as Consumer Duty may apply to some products and services in your distribution channels, but not others.

Unless the answer is obvious, knowing whether Consumer Duty applies to you or not will require careful consideration, mainly in understanding how your distribution chain works from start to finish, where your firm sits in the chain and what it does, in the context of the services being provided to retail customers at the end of that chain. If you are deemed to have a 'material influence' over the end-user retail customer's outcomes, then you are likely to be caught by Consumer Duty.

How does this affect the wealth management sector?

Whilst traditionally the sector developed by helping the affluent grow and preserve their wealth, there has been - albeit slowly over a number of years - a clear shift away from this traditional approach to wealth management.

Several factors have contributed to this: the cost-of-living crisis; the rise of wealth in younger (and older) generations; the significant increase in the use of innovative and disruptive technology making products/services more accessible; and social media and outreach of investment platforms.

All of these factors contribute to the way that the general population now think about, and value, money.

This shift from traditional origins to a more consumer-focussed model places an oversight on the wealth sector that will be new for some firms, particularly when compared with well-established consumer-driven markets, such as insurance and credit. We anticipate that certain products and services being offered by managers or platforms will receive increased oversight from the FCA in light of Consumer Duty.

However, wealth managers are already adept at client categorisation requirements and changes to compensation rules, so will be in an advantageous position when compared with some other sectors in embedding the correct processes.

On client categorisation, the FCA's **'Dear CEO' letter** to asset managers (and others) reminded firms that High-Net-Worth clients are retail investors and, therefore, retail customers for purposes of Consumer Duty. Where a firm has incorrectly classified a retail investor as a professional investor, this is not an issue, as long as a rectification exercise has been taken out, which includes, the re-categorisation of the investor (from professional to retail) and the appropriate level of consumer protections being applied (whether by Consumer Duty or relevant risk warnings for retail investors).

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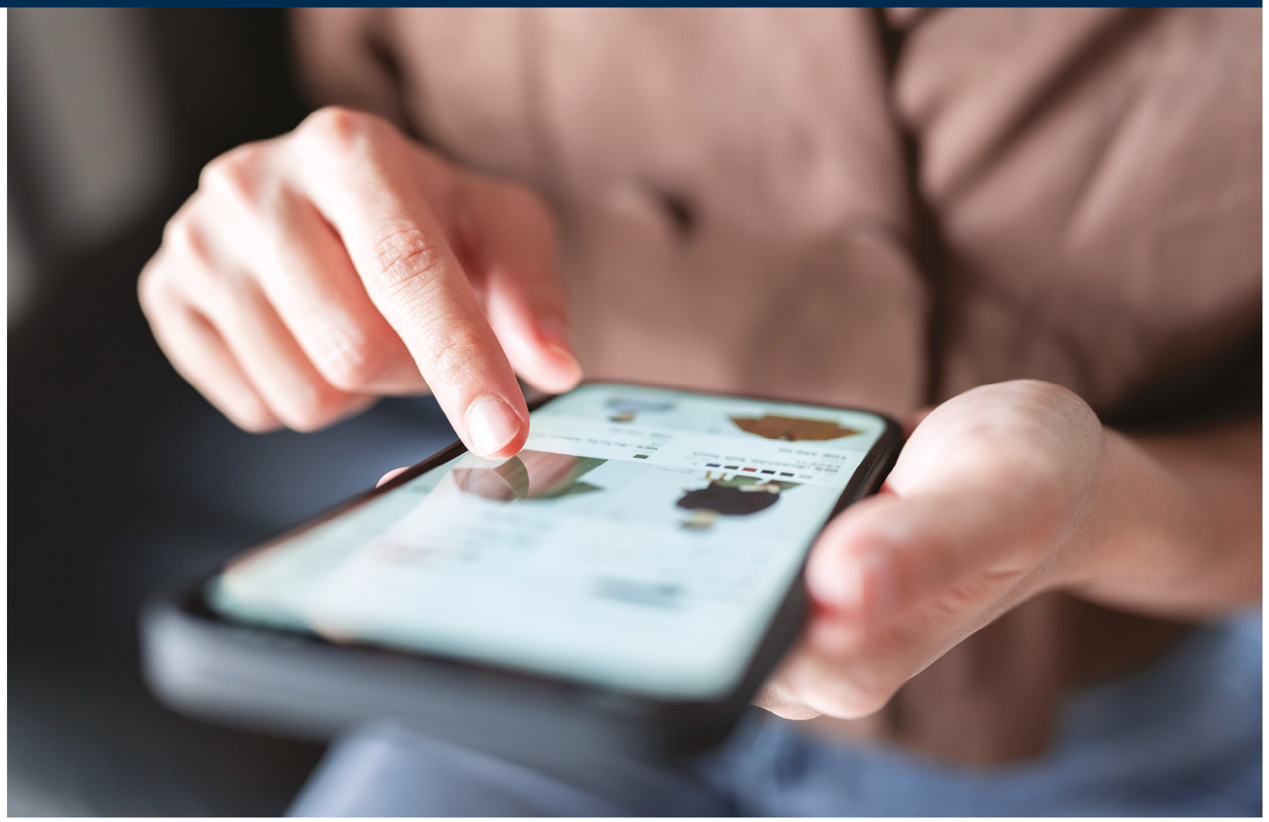

It has been reported that **St James's Place** has recently offered a reduction on fees for loyalty. The reduction followed St James's Place's assessment of Consumer Duty and how it applied to a particular product. This type of assessment typifies what the FCA will expect to see carried out in the wealth management sector. Not to say that a quick workaround - for firms aiming to demonstrate compliance with the Consumer Duty - is to cut fees. The FCA emphasises that firms should take a proportional approach, therefore a reduction of fees is not designed to inhibit natural business growth, rather firms should ask what is the fair value for a particular product, i.e. what is a reasonable price for consumers to pay, and is this appropriate with respect to the benefit they are receiving when taking out a particular investment product/service?

What is the impact so far?

Given we are in the early stages of Consumer Duty being in force, the FCA's approach remains to be seen. We expect to see a more robust, proactive approach being taken by the regulator, as months go by.

The FCA plans to conduct a review across firms in the wealth sector and on a range of models, from authorised fund managers to investment managers, focusing on the second outcome; price and value.

Given the wealth of literature, support, and guidance the FCA and other independent trading bodies have posted in this area, there will be an expectation that firms are 'living and breathing' Consumer Duty, especially when it comes to product design and fair value. Wealth management firms are on the FCA's radar, given the nature and risk levels associated with products.

Firms that responsibly promote services to retail customers, by helping customers invest wisely and arming them with the relevant knowledge ahead of making any investment decisions, will fare well in terms of the implementation of the Consumer Duty principle, as those businesses capture the essence of good outcomes for retail customers.

If Consumer Duty is relevant to your organisation, you will hopefully already have your implementation plan in place. Embedding Consumer Duty into your systems, processes and controls should not be a static process but one that continually evolves, following a system of regular and proactive reviews, improving on processes, where appropriate.

We anticipate the FCA's review of firms' implementation of Consumer Duty will focus heavily on data. The FCA expects firms to 'assess, test, understand and evidence' the Duty. Whilst the FCA has said it will be pragmatic with firms in improving their use of data and technology to evidence compliance, we expect its approach in compliance with Consumer Duty itself to be robust. WealthTech firms by their nature, embedding technology into their business model will therefore be in an excellent position to demonstrate delivery of good consumer outcomes.

Tara Swaminathan
Solicitor
t.swaminathan@capitallaw.co.uk

Charlotte Gregory
Partner
c.gregory@capitallaw.co.uk

Capital Law