

# UK Adopts a New Consumer Duty: Key Implications for Financial Services Firms

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The UK's Financial Conduct Authority (FCA) published final guidance ([FG22/5](#)) and a policy statement ([PS22/9](#)) for the new consumer duty (Duty) on 27 July 2022. The main rules will come into force on 31 July 2023 for existing products and services, meaning those available for sale to new customers, or available for renewal by existing customers.

The immediate deadline firms must consider is 30 April 2023, when they must have finished their review of existing open products. For closed products or services, the rules will come into force on 31 July 2024.

There are three parts to the Duty:

- the **Consumer Principle (Principle 12)**, requiring firms to deliver good outcomes for retail customers. This reflects the overall standard that the FCA expect firms to adhere to.
- the **Four Outcomes**, and,
- the **Cross-Cutting Rules**.

The Duty has been described by the FCA as a 'major shift' in the UK financial services regulatory landscape, building on the existing framework of principles-based regulation. The Duty exists alongside and operates in parallel with product governance rules and other FCA rules and principles aimed at mitigating consumer harm, as well as obligations derived from general laws, including consumer protection legislation.

## Implementation Period

The FCA has set out a number of milestones which firms are expected to hit, extending over a protracted period, reflecting the magnitude of the implementation process:

- By the end of October, 2022, firms' boards should have agreed on implementation plans and begun oversight of delivery.
- By the beginning of 2023, manufacturers should have completed all reviews necessary so that by 30 April 2023 they can satisfy the Four Outcomes described below for their existing open products, including:
  - sharing key information with distributors three months ahead of the implementation deadline to ensure that the distributors can comply with the duty in time, and,
  - identifying where changes need to be made to existing open products and services to meet the Duty and implement these remedies by 31 July 2023.

The FCA has also recently published [a review of the implementation plans](#) of a number of larger firms operating in the retail financial services market. Although many of these firms showed an understanding of the Duty, the FCA found deficiencies in some implementation plans that suggested some firms are behind schedule. For example, the FCA cited implementation plans that: provided insufficient detail as to who is leading implementation programmes; used unclear methodologies for assessing the compliance of products and services with the Four Outcomes; or did not identify key third-party relationships or dependencies in their implementation plans.

## Who Must Consider the Consumer Duty?

The Duty applies to products and services that are provided by UK-authorized firms to 'retail customers', divided into four financial services categories, as follows:

# UK Adopts a New Consumer Duty: Key Implications for Financial Services Firms

- For investment services, the Duty applies to business conducted with a 'retail client' and does not extend to 'professional clients' (either opted-up or *per se* 'professional clients'), nor eligible counterparties.
- For consumer credit business, it applies to 'consumers' served by authorised consumer credit businesses, but excludes corporates and SMEs.
- For deposit-taking, as well as payment service and e-money providers, the Duty applies to products provided to consumers, micro-enterprises and small charities.
- For insurance business, the Duty applies when services are provided to 'individuals acting for purposes outside of their trade, business or profession'.

Importantly for fund managers, for funds that are available for purchase for both retail and professional clients, there is an exclusion where (i) the marketing materials feature prominently that the instrument is only being offered to professional clients or eligible counterparties, and not retail clients and (ii) the issuer or the distributor has taken reasonable steps to ensure that the offer and promotional communications are only directed towards professional clients or eligible counterparties. This exclusion broadly aligns with current practice, although firms should nevertheless confirm that their financial promotions are only addressed to professional clients and eligible counterparties.

## What About Unauthorised Businesses?

The FCA expects firms that are currently applying for authorisation in the UK to have started putting in place arrangements and controls so they will be able to comply with the Duty when it comes into force.

As the Duty only applies to UK-authorised firms, unauthorised firms (those not licensed in the UK) that provide services to customers located in the UK will not be directly in-scope, although some of them that benefit from an exemption to authorisation may need to consider the Duty. For example, appointed representatives<sup>1</sup> can expect that their principal will impose additional requirements on them.

In addition, the Duty requires UK-authorised firms distributing products manufactured by non-UK firms to take all reasonable steps to understand the product or service, the target market and

<sup>1</sup> An appointed representative (AR) is an entity which is exempt from UK authorisation requirements by virtue of having entered into an AR agreement with an authorised firm, which will take regulatory responsibility for the actions of the AR. Although it offers easier access to the UK financial services sector, only certain types of regulated activities are covered by the AR regime.

the value the services provide. This means that firms that are part of a distribution chain, even those outside of scope of the Duty, can expect to be indirectly affected by the Duty.

Once the Duty takes effect, the FCA also expects firms that acquire a product or service book from a regulated entity to obtain adequate information from the seller to understand the product or service in terms of design and value.

Given the importance of the Duty and the magnitude of the task ahead to comply with it, firms seeking to acquire a UK-regulated financial services entity will want to review the target firm's implementation plan as part of their due diligence exercises.

## The Four Outcomes

The Four Outcomes set out detailed expectations for in-scope firms regarding four key areas of the customer relationship:

- **Products and services outcome.** Firms must develop and design products which are fit for purpose, meeting the needs, characteristics of the customers in the identified target market. Distributors will also need to ensure that the distribution strategy for a product is appropriate for the target market. The FCA expects that firms will comply with this by testing their products and services and by conducting regular reviews of the firm's product and services book. This may include conducting focus groups, requesting appropriate information from manufacturers where relevant, and remedying issues identified through such reviews. Helpfully, the FCA has stated that complying with the product governance rules (applicable to firms providing or distributing financial instruments, structured deposits, insurance products and funeral plans) is equivalent to complying with the products and services outcome.
- **Price and value outcome.** This focuses on the prices charged by firms for products and services, benefits received by the customer, and evaluating non-financial costs. The FCA has stated that firms need not charge the same price to all customers; differential pricing may be appropriate. Firms that do not directly interact with customers may be able to give this less consideration, though they must still consider their role within the overall value chain. We expect that firms may find it difficult to be certain about satisfying this outcome, because it is not clear whether prices are to be assessed in relation to other firms or in relation to the revenue and profit margins generated by their products. The latter can be difficult to measure given that wholesale products in particular are often provided as a part of an overall platform.

# UK Adopts a New Consumer Duty: Key Implications for Financial Services Firms

- **Consumer understanding outcome.** Here, the goal is to ensure that customers can make informed decisions about their financial services and products. Firms will need to consider what kind of information a customer will need in order to make effective decisions and make that available. Firms will be barred from providing misleading information, exploiting their customers' behavioural biases or making it difficult to obtain key information. In areas such as retail funds, where standard disclosures are required under existing regulatory requirements, firms will need to further consider whether that information is fit for purpose and can satisfy this outcome.
- **Consumer support outcome.** This needs to be considered in conjunction with the FCA rules on complaints and dispute resolution with customers. It requires firms to design facilities to meet the needs of their customers, ensure that products can be used as reasonably envisaged and, in the case of high-risk products, ensure that there is sufficient 'friction in customer journeys' (enough time to understand the product they are purchasing, and mitigate the risk of harm). In complying with this, the FCA expects firms to take active measures to analyse data to evaluate potential risks to customers, including by monitoring channels of support, analysing customers' use of products and services, and analysing contact resolution rates and time to resolution.

In implementing the Four Outcomes, firms will need to consider what exactly is the behaviour expected of them, and whether they need to act in a manner that is more fiduciary in nature. There is significant overlap, however, in the practical steps required to comply with each outcome. The FCA states that firms must conduct behavioral analysis, segment their target markets and monitor customer outcomes. Implementing such controls will help satisfy (or feed into the analysis of) more than one outcome.

Given the generality of the rules, firms may struggle to understand and implement robust programmes to meet the requirement of each outcome. The FCA has provided specific examples of compliant and non-compliant behaviour, but many of these relate to behaviour that clearly contravenes the rules, so they may not be particularly helpful in making decisions in situations that require more nuance.

## The Cross-Cutting Rules

The FCA has also published rules providing overarching conduct standards which need to be adhered to whilst delivering on the Four Outcomes. These are dubbed the Cross-Cutting Rules and apply both on an individual level (for example, when advising clients or when providing customer support) and on a target-market level (for example, when designing products and services or pricing products). The Cross-Cutting Rules are as follows:

- **Acting in good faith.** The FCA describes this as a standard of conduct characterised by honesty, fair and open dealing, and consistency with the reasonable expectations of customers.
- **Avoiding foreseeable harm.** Crucially, the FCA does not equate this to the prevention of any harm, but provides examples of foreseeable harm, such as products and services performing poorly due to poor market testing, customers incurring high charges due to not understanding the product charging structure or due to inherent flaws in the product's fee structure.
- **Enabling customers to pursue their financial objectives.** This is focused on ensuring that firms enable customers to effectively act in their own interest, both through information provided and in considering the product lifecycle.

In attempting to apply the Cross-Cutting Rules, it is worth noting that conduct which breaches one of the rules may also breach another as well. For example, behaviour that is in bad faith (such as concealing critical information) may also cause foreseeable harm. Given this overlap, we expect that, for the most part, it will be clear whether aspects of firms' products and services are compliant or in breach of the Cross-Cutting Rules.

## Disapplication of Principles 6 and 7

A number of high-level FCA principles apply to all UK-authorized firms. Principle 6 requires firms to pay due regard to the interest of customers and treat them fairly, and Principle 7 requires firms to pay due regard to the information needs of their clients, and communicate information to them in a way which is clear, fair and not misleading.

Given the overlap with the consumer duty regime, both of these principles are now disappplied where the Duty is in scope. Principles 6 and 7 will, however, remain relevant for the purposes of non-retail business, for example, when providing services to wholesale or corporate clients, or certain SMEs.

## Governance and Senior Managers

The introduction of the Duty is also accompanied by a new Individual Conduct Rule 6, as part of the Senior Managers and Certification Regime (SMCR), which requires senior managers and conduct staff to take personal responsibility for their actions, and permits the FCA to take action against individuals for failing to adhere to the Conduct Rules.

Individual Conduct Rule 6 requires conduct staff to 'act to deliver good outcomes for retail customers', as well as a new Duty of Responsibility which must be allocated to a senior manager. Senior managers will also be expected to sign off on an annual assessment of the firm's monitoring of the Duty. The FCA has

# UK Adopts a New Consumer Duty: Key Implications for Financial Services Firms

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also stated that firms are expected to appoint a consumer duty champion at the board or equivalent level, to challenge firms' management on their plans to embed the Duty and focus on consumer outcomes.

In line with the UK regulators' continued focus on culture in financial services, the FCA has stated that there is a direct link

between culture and adherence to the Duty. The FCA's view is that culture includes the firm's purpose, leadership, people and overall governance, each of which needs to be geared towards delivering good outcomes for customers. The FCA has directed that a firm's controls and key processes must enable it to identify where it does not deliver good outcomes, and therefore where a firm falls short under the standards of the Duty.