Asset Management

Consumer Duty – Distribution

Norton Rose Fulbright LLP - May, 2022

Introduction

A significant reform to the manufacture and distribution of financial products and services

The new Consumer Duty is set to reform the ways in which financial services firms manufacture and distribute products to retail customers.

The extent of this reform, and the scale of the impact is likely to vary between sectors, as well as between firms depending on their role in the distribution chain.

The Consumer Duty will apply across the distribution chain

The new Consumer Duty is proposed to apply across the distribution chain and, if the final rules reflect those being consulted on, would apply to firms even where they do not hold a direct contractual relationship with the underlying retail customer.

Listen to our podcast which supplements this paper

In our first podcast in our series on the new Consumer Duty, we considered some of the practical issues which firms across the distribution chain will need to resolve in order to achieve the new products and services outcome.

This paper considers the key issues for consumer finance firms

In this paper, we set out some of the key issues which asset managers should consider now in order to map the potential impacts of the new Consumer Duty ahead of commencing implementation projects following publication of final rules this summer.

What are the key challenges that asset managers will need to meet to comply with the new **products and services outcome**?

The purpose of this outcome is to ensure that firms act so as to deliver good outcomes for consumers. This is one of four outcomes, with which firms will need to comply in order to meet the new Consumer Principle, and goes beyond current requirements to ensure that products and services are provided to a particular group of customers, as required by the target market assessments. The need for products and services to provide **fair value** to retail customers sits as a complimentary outcome that firms will need to explore. We will cover this in more detail in a future podcast in the **New Consumer Duty series**.

The products and services outcome is underpinned by particular rules and extensive guidance, both in the proposed FCA handbook text and in the additional draft non-handbook guidance included in the FCA's latest consultation on the Consumer Duty. In essence, the products and services outcome is about ensuring that firms design and sell products which meet consumer needs and are targeted more precisely at those retail customers for which they are designed.

The new Consumer Duty will require asset managers who manufacture products for retail clients but do not have any interaction with or contractual relationship with those clients to consider how their products and services meet the ultimate clients' needs.

Background

The new Consumer Duty will apply across all areas of the regulatory landscape in connection with financial services and products provided to retail customers. This will bring big changes to areas such as core retail banking, in the mortgages sector, consumer credit, payments and others that all deal directly with consumers. But it will also affect areas such as investment banking and asset management, even where those firms do not themselves have a direct relationship with any consumers.

The FCA originally proposed two options for the Consumer Duty – either firms would have to act to deliver good outcomes for consumers or they would be required to act in the best interests of retail clients. It was decided to pursue the first option and the products and services outcome reflects that choice. This will require all parts of the financial industry which contribute to products and services ultimately sold to retail clients to consider how to act to provide good outcomes both over the life cycle of products and over the lifetime of consumers, while taking the different needs of different segments of the consumer market into account. The implementation of this requirement will differ widely between different parts of the financial industry and it is impossible for asset managers, for example, to take the same approach as a bank providing mortgages.

Co-Manufacturing

The new Consumer Duty will expand and build on the existing product governance rules. Of particular interest from an asset management perspective in this context will be the requirement that firms enter into a co-manufacturer agreements in which they should be identifying their respective responsibilities for the manufacturing of the relevant product or service. The definition of 'manufacturer' under the Consumer Duty is wider than that under MiFID. In addition to creating, developing, designing and issuing products/services, manufacturing for Consumer Duty purposes will also capture operating or underwriting a product or service.

The package of rules and guidance making up the **new Consumer Duty** aims to bring about a cultural change within firms so that the focus of the business is on the underlying consumer outcomes: firms will need to identify, monitor and achieve the outcomes they set and will need to make the organisational changes necessary to underpin this development to the regulatory environment. Given the focus on outcomes for consumers, we expect that it will take time for firms to define their role(s) as co-manufacturer for different products and services and to understand who all their co-manufacturers would be in each instance. Some asset managers may need to take a more holistic and expansive approach to their mapping of distribution arrangements in the first instance, to understand the full spectrum of impacts of the new

Consumer Duty and, importantly, how others in the chain of distribution expect to comply and what that will mean for information flows between the parties to achieve the FCA's expectations.

It will be important for all firms involved in the distribution a product or service to understand where individual firm responsibilities begin and end and, in relation to co-manufacturers, how to document the split of responsibilities in an agreement. Importantly, as the FCA have already made clear firms cannot contract out of or delegate their regulatory responsibility as co-manufacturers, the co-manufacturer agreements must accurately reflect all parties' roles and any information or data sharing between the different co-manufacturers. This will likely be one of the key challenges across the industry, but particularly for structures where asset managers work with others to create products and services.

Distribution chains

As already mentioned, the other main challenge for asset managers will be the need to work with the entire distribution chain, which will require information sharing from the manufacturer all the way to the consumer-facing distributor. We expect that the requirement to ensure good outcomes for customers will lead to a greater onus on asset managers to receive information about how the products and services they manufacture perform throughout the product or service lifecycle. This information will then need to be integrated into any product reviews and the development of new products.

While the information required will need to be shared along the entire chain from manufacturer to final distributor, it is not clear whether everyone in the chain will be comfortable making confidential cost information available. There are also broader considerations around competition law to take into account when thinking about how to implement these new requirements. This will create challenges for firms, as they will need to find a way to comply with the products and services outcome without breaching any competition law obligations and while managing with their commercial positions as well.

One point to note is that the FCA's approach to the requirements on each firm in the distribution chain is similar to its approach to co-manufacturers in that each entity remains responsible for its own regulatory compliance, but in order to ensure that compliance, there will need to be a degree of cooperation between firms.

This process will very likely require reviews of all distribution agreements and discussions with the different distributors as to how the new requirements can be added to the existing arrangements.

Implementation considerations

The new Consumer Duty is not drafted as a static set of rules. The FCA has deliberately created an 'agile' approach, and asset managers will need to map the way in which they interpret the new Consumer Duty carefully, showing how it applies to them as potential co-manufacturers and given their place in the distribution chain and building an implementation and compliance approach based on this understanding of the scope of the Consumer Duty.

This includes the FCA's 'proportionate application' approach, whereby the Consumer Duty applies depending on where a firm is in the distribution chain. A general expectation is that the greatest responsibility will apply to the firm which has the direct contractual relationship with the retail client, but it would be a mistake to assume that the FCA is therefore implying that the manufacturers bear less of a responsibility for the products and services outcome. We expect that a consensus position will begin to emerge over time for particular structures, but in the meantime the prudent course of action for asset managers is to establish and document their interpretation of the scope of application and, where possible engage with third parties and advisors to challenge and test this before embarking on implementation projects this Autumn.

The FCA has also provided its view regarding the reasonable application of the Consumer Duty, which again might be taken to impose the largest burden on those firms with the direct contractual relationship with the consumer. However, the FCA does also highlight the need to consider the 'risk of harm' when considering the obligations imposed by the Consumer Duty and here asset managers as manufacturers will need to consider carefully how their products and services are marketed and whether they need a more granular target market assessment. It may be worth considering how the increase in UK households who lack financial resilience might impact on the products and services that asset managers manufacture.

Firms will no doubt by now also understand the significance of the FCA's approach to application of the products and services outcome to existing products and relationships, and the challenges presented by where it is concluded that off-sale products may not product good outcomes for customers. The FCA will take a close interest in the governance of decisions made so as to mitigate the risk of any identified harms to existing customers. Whilst the FCA has said that it does not expect firms to give up any contractual rights that they **had a firm expectation to enjoy**, there will doubtless be close scrutiny of the extent to which those rights were clearly explained and understood by customers. Given the potential economic impact of the application of aspects of the new Consumer Duty to existing products and services, firms would be well advised to allocate appropriate resource to this review as a standalone workstream within the overall implementation project.

All of the decisions taken in relation to these aspects will need to be documented and subject to appropriate governance oversight. The outcome will then be used by each asset manager to assess what information they need from their co-manufacturers and distribution chains, what actions are required by their co-manufacturers and distribution chains to enable the asset manager to meet its own obligations and how to agree and document this between all the parties involved.

Practical examples of how the new Consumer Duty will impact on firms in the chain of distribution of investment products

Putting in place new agreements between co-manufacturers and repapering distribution agreements are both significant exercises and neither can be started without a holistic understanding of how the Consumer Duty will impact on an asset manager's particular business. This will include understanding

- what benefits the products and services are intended to provide for a customer;
- what the characteristics of consumers in the relevant target market will be; and
- what the firm's role is in relation to the products and services are.

All of this will be necessary to create co-manufacturer agreements and to amend distribution agreements to ensure that the asset manager has all the information necessary from the other(s) to comply with the products and services outcome and other components of the Consumer Duty.

The requirement to conduct (and provide) a fair value assessment for products and services, which forms a key plank of the **price and value outcome**, needs to be considered early on. Implementing the FCA's value assessment for funds was a difficult and time-consuming process for many fund managers and while it will be possible to build in this knowledge, the implementation time for the fair value assessment requirements should not be underestimated.

For both co-manufacturers and distribution chains, it will be necessary to consider how any non-UK firms will be integrated into the new requirements, given that they are not themselves in scope, but dealing with UK firms who need to comply with these new requirements.

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