Wealth Management and Retail Brokerage

Consumer Duty – Distribution

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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 wealth management and retail broker firms

In this paper, we set out some of the key issues which wealth managers and retail brokers should consider ahead of commencing implementation projects following publication of final rules this summer for the Consumer Duty.

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

For most wealth managers and retail brokers, much of the 'products and services outcome' will be recognisable from MiFID II's product governance regime (as implemented by the FCA in their PROD sourcebook).

The FCA's 'products and services outcome' has built on these product governance requirements to produce a set of outcomes that are more tailored for the manufacturing and distribution of products to retail customers.

In the first instance, one of the key challenges for wealth managers and retail brokers will be to understand whether they are 'manufacturers' and/or 'distributors' under these proposals, and the categorisation of their immediate counterparties (as this will impact on their obligations under the Consumer Duty). It is important to note that the definition for these terms in the Consumer Duty is wider than the equivalent MiFID II product governance definitions, and so firms cannot simply rely on their MiFID II categorisations, and so will need to undertake a fresh scoping exercise.

Although the Consumer Duty is intended to have a wide scope in application, and is (as currently formulated in FCA CP 21/36) intended to capture all firms with a material involvement in the distribution chain of products to retail customers, we expect that there will be a greater onus on firms in the distribution chain that are immediately facing retail customers – such as wealth managers and retail brokers. This is likely to be due to the level of influence that these firms can exercise in relation to the distribution of products to customers and the steps that they can take to ensure that they deliver good outcomes for customers – rather than simply ensuring that the customer is within the target market.

Similarly, as wealth managers and retail brokers will have greater information on the nature of the end customer receiving the relevant product/service, there may be greater scrutiny from the FCA on how these firms have adapted their distribution strategies to ensure that they achieve good outcomes for these customers.

For example, the **products and services** outcome includes a much greater focus on vulnerable customers (as compared to the MiFID II product governance requirements), and so it is likely to be incumbent on firms facing customers to understand the level of vulnerability in their customer population and then consider what changes may need to be made to its distribution channels.

This could also require firms having to go back up the distribution chain to the manufacturer to request changes to the product to accommodate any common vulnerabilities within their target market in order to ensure that customers receive 'good outcomes'. This flows from the current uncertainty within the FCA's cross-cutting rules – that sit above these outcomes – of the extent to which firms must act in order to satisfy their requirement to **take reasonable steps to avoid foreseeable harms** to customers.

In line with the MiFID II product governance requirements, a key element of the **products and services outcome** also includes the sharing of information in the product lifecycle to ensure that manufacturers and distributors can make changes to reflect how their products/services are actually sold/used within the market. As wealth managers and retail brokers are often facing, or closer to, the customer, we expect that there will be a greater onus on these firms to report information back up the distribution chain to other distributors/the manufacturers on how their products/services are actually being used. For example, we expect that there is likely to be a greater focus on the sharing of complaints information and how products/services have performed for vulnerable customers.

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

In the first instance, we expect that many firms will be able to use their existing control framework for compliance with the MiFID II product governance as a good starting point for compliance with these new requirements under the Consumer Duty proposals.

This is in part recognised by the Consumer Duty proposals themselves, which state that where both the Consumer Duty and MiFID II requirements apply, compliance with the MiFID II requirements will **tend** to establish compliance with the Consumer Duty requirements. Notwithstanding this, we expect that firms will still need to make adjustments to their existing control frameworks, and in particular to their arrangements with third parties in order to comply with the 'products and services outcome'. There are a number of differences in the scope of application between PROD and the new 'products and services' outcome which firms will need to fully work through and, in particular consideration will need to be given to **closed products** which may have been out of scope of MiFID II implementation.

We expect that as the firms with direct relationships with consumers, wealth managers and brokers will also need to review their existing product approval (and review) processes to take account of the greater focus on vulnerable customers. We expect that there will also need to be a focus on ensuring that products/services deliver good outcomes for customers, not just that they have been distributed to the target market. There is also a much keener focus on firms' processes around monitoring the outcomes received by retail customers, and using this information in a feedback loop to inform ongoing product development and customer communications.

In terms of third party relationships, we expect that this will have the following impacts:

- **Co-Manufacturer Agreements**
  - following the initial scoping exercise to understand where new co-manufacturer agreements are required, wealth managers and retail brokers will need to (re-)paper their arrangements with other co-manufacturers, which will involve identifying their own regulatory responsibilities under the Consumer Duty (and in particular in the context of the product approval and review processes);
- **Distribution Agreements**
  - we expect that wealth managers and retail brokers will need to review their existing distribution agreements with third parties to ensure that they are receiving sufficient information from upstream/downstream distributors of the products/services. This is to ensure that wealth managers and retail brokers can take reasonable steps to ensure that they are delivering good outcomes for customers (i.e. by understanding the level of complaints in respect of any product/service, further granularity over the target market assessment/benefits of the product and its potential impact on vulnerable customers, etc).

Although the FCA's Consumer Duty appears to drive at greater information sharing between parties in the manufacturing process/distribution chain, we understand that there may be friction between this objective and commercial sensitivities for firms in the market (e.g. wealth managers/brokers may not want to provide commercially sensitive information on its distribution methods/customer base/strategies that all inform the outcomes that customers may receive).

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