

International Regulatory Strategy Group (IRSG)

Response to FCA CP26/23: Consumer Duty – scope and proportionality

Introduction

The International Regulatory Strategy Group (IRSG) is a joint venture between TheCityUK and the City of London Corporation. Its remit is to provide a cross-sectoral voice to shape the development of a globally coherent regulatory framework that will facilitate open and competitive cross-border financial services. It comprises practitioners from the UK-based financial and related professional services industry who provide policy expertise and thought leadership across a broad range of regulatory issues. The IRSG welcomes the opportunity to respond to the FCA's consultation paper.

Alongside our chapter-by-chapter response, we ask the FCA to address the following overarching points. Doing so would clarify the scope and proportionate application of the Consumer Duty, strengthen the distinction between retail and wholesale activity, and reduce unnecessary compliance costs and complexity.

- We support the FCA's intention to address concerns about applying the Duty to firms primarily engaged in wholesale activity. However, many members consider the proposals largely clarificatory. The FCA could go further to provide certainty and demonstrably reduce compliance burdens for firms that conduct predominantly wholesale business
- The FCA's stated aim was to 'make the Duty more precise, proportionate and workable in wholesale markets'. Subject to a firm's sector, business model and customer base, there are some enhancements and improvements, for example, the revisions to the territorial scope and the exclusions in the definition of retail market business. However, the introduction of new concepts, for example, on co-manufacturing, has the potential to introduce unintended complexity and uncertainty, thereby reducing the potential benefits of the exercise.
- Some firms expect the changes to have little effect on how they interpret and apply the Duty, given that the FCA's expectations remain largely unchanged. The consultation expressly states that the FCA 'have not eliminated the need for judgement'. While judgement is inherent in an outcomes-based regime, the introduction of new concepts is likely to require firms to re-scope their entire retail customer business, contrary to the FCA's intention
- The industry would benefit from clarity on whether the revised rules are intended to apply retrospectively to existing products and services. The FCA must be explicit about its intended approach and, if the rules will apply retrospectively, work with firms to identify an appropriate time period for them to review their retail customer business.
- The FCA should confirm, before publishing the final rules, whether they will take effect immediately in Q1 2027 or after an implementation period.
- Before implementation, FCA sector-specific policy and supervisory teams should engage with firms to establish a shared understanding of good practice. This would reduce variation in firms' experience and support consistent supervision, reporting and monitoring.

Chapter 2: The scope of the Duty: firms with customers outside the UK

We support limiting the Duty's territorial scope by reference to the usual residence of retail customers. However, the Handbook currently uses different terms for related concepts, creating scope for inconsistent interpretation. For example, the following illustrates the current lack of alignment:

- ICOBS defines non-UK customers as those 'habitually resident' overseas.
- PRIN references 'usually resident' under the Consumer Duty. Non-handbook guidance 2.51 references 'Non-investment insurance contracts'.
- PROD links to the 'overseas non-investment customers' definition.

The FCA's 'Simplifying the insurance rules' consultation is a related opportunity to address this. It uses the term 'habitually resident', and links conduct obligations to risk location. The FCA should implement common terminology, aligned glossary definitions and a consistent territorial framework across PRIN, ICOBS and PROD. Members suggest that a consistent definition should focus on risk location.

More broadly, where risk location is intended to be relevant to the Consumer Duty scope, this should be reflected explicitly in the Handbook rules rather than relying solely on non-Handbook guidance.

The FCA should also clarify the treatment of Crown Dependencies and British Overseas Territories; customers who were UK resident at the point of sale but later moved abroad; and UK-resident non-UK nationals who subsequently moved outside the UK.

It should also explain its expectations for outcome monitoring where in-scope and out-of-scope customers are included within the same monitoring framework, including where firms voluntarily apply the Duty more broadly for operational or governance reasons.

Additionally, further guidance would be helpful on the expectation implied by 'becomes aware' in PRIN 3A.5.5R. It is unclear whether firms are expected only to maintain preventative controls to minimise the risk of sales to UK-resident customers or whether they should also undertake ongoing monitoring to identify such instances. Clarifying how this interacts with product governance, target market assessments and distribution strategy reviews would promote consistency.

Chapter 3: The scope of the Duty: activities subject to the Duty

In overall terms, the proposed reforms contain helpful elements for some firms by providing clarification of their obligations under the Duty. We are supportive of the following proposals relating to the activities that are subject to the Duty:

- Excluding certain activities, for example, addressing the ambiguity around custodians appointed by fund managers who do not interact with retail clients or investors.
- Confirming that firms are not captured by the Duty where their instruments (derivatives etc) are independently incorporated into retail products.
- Amending the rules to clarify that firms don't need to comply with rules under one or more of the four outcomes in PRIN 2A.3 to 2A.6 if they don't conduct a particular role, process or

step that is the subject of these rules. This formalises the approach that many firms already take. However, insofar as the cross-cutting rules relate to the four outcomes, the FCA should clarify whether firms need to comply with all the cross-cutting rules if one or more outcome rules have been identified as not relevant. In practice, the vast majority of firms apply a high bar to assessing the scope of activities subject to the Duty. The effect of the cross-cutting rules, unless otherwise amended, could be to reintroduce an obligation even if, in theory, it has been removed through disapplying one or more of the four customer outcomes.

However, for many firms we do not expect the proposals relating to the scope of the Duty and the new ‘simplified’ product definition to materially change their understanding or application of the Duty. The revised definition of retail market business is widely drawn and perhaps understandably, in contrast to the list of exclusions, lacks specificity.

The revised definition covers a broad range of activities, including manufacturing, distribution, financial promotions, price-setting and product literature. It also captures other pre-sale and post-sale services or functions related to a product or service, such as transaction and claims handling, product administration, support and complaints handling.

Firms will therefore need to make their own scoping determinations, which may lead to inconsistent approaches across the industry. The risk is particularly acute in distribution chains because the consultation’s relationship examples rely on the revised, broadly drawn definition of retail market business.

We support the formalisation of rules and updates around the concepts of material influence, which can help deliver a more proportionate approach to the application of the Duty. However, the terms ‘limited’ and ‘remote’ are open to interpretation, and the consultation uses inconsistent wording to describe whether firms fall within scope. For example, it is not clear why the wording of section 3.21 is not exactly mirrored in appendix 3 as set out below.

Section 3.21 of the consultation (page 19 of the CP PDF)

The Duty doesn’t apply to firms with a limited or remote role, such that they are unable to determine or influence outcomes for retail customers in relation to a product or service. Where a firm carries on retail market business and in respect of which no specific exclusion applies, but where it doesn’t have any material influence over retail customer outcomes, it wouldn’t be subject to the Duty.

Appendix 3 Proposed changes to the non-Handbook guidance (page 148 of the CP pdf)

2.37 The Duty doesn’t apply to firms with a role so limited or remote that they are unable to determine or influence outcomes for retail customers in relation to a product or service.

2.38 Where a firm carries on retail market business, where no specific exclusion applies, but where it doesn’t have any material influence over retail customer outcomes, it isn’t subject to the Duty.

Furthermore, it is not clear why the text above omits the reference to the need for a firm to demonstrate that it cannot determine or materially influence outcomes, as noted below in the draft handbook text. This itself introduces a further term, ‘determine’, in addition to ‘materially influence’. This may appear to be a minor inconsistency, but this is a real-life example of the level of detail that firms apply when assessing their regulatory obligations.

Appendix 2 Draft Handbook Text (page 124 of the CP PDF)

PRIN 3A.4.7 | R In relation to a firm in a distribution chain, the Consumer Duty does not apply where the firm is able to demonstrate that its role in relation to a product is so limited or remote that it cannot determine or materially influence outcomes for retail customers in connection with that product.

Elsewhere in the paper, there are tables or lists of actions or activities that can help a firm assess its obligations and/or whether its actions are likely to be consistent or inconsistent with Duty outcomes.

The FCA should provide indicative examples of the kind of evidence it would reasonably expect a firm to gather to demonstrate that the Duty does not apply because the firm’s role in influencing retail customer outcomes for a particular product is limited or remote.

The FCA has sought to provide greater clarity on manufacturer responsibilities. However, the proposed removal of ‘co-manufacturing’ and the introduction of the new concept of ‘principal’ and ‘secondary’ manufacturers has raised concerns across the industry.

Firms undertake a broad spectrum of activities when working with others, from providing components of a retail product manufactured by third parties to strategic, ongoing collaborations, with a range of activities and approaches in between. The existing rules are already difficult to interpret consistently, and the introduction of these new concepts appears to introduce unnecessary uncertainty and new complications. For example, additional guidance and sector-specific examples are needed to explain ‘substantive control’ and the practical distinction between principal and secondary manufacturers.

Members noted that co-manufacturing is a definition that works well in general insurance where the insurance company and distributor often play significant roles in developing the product together. An intermediary may define the product wording and market(s) before seeking out an insurer to underwrite the risks. The FCA’s proposals are helpful for investment markets but are an unhelpful and disruptive reset for firms to whom PROD 4 applies.

It is not clear that the FCA has considered the level of re-scoping and related analysis that firms will have to undertake and whether that is proportionate to the potential benefits of the new approach. Furthermore, alignment with PROD is essential. Divergent terminology and guidance between PRIN and PROD could create inconsistency and confusion across distribution chains, particularly where some firms are subject to PRIN and others align primarily to PROD.

Chapter 4: Proportionate application of the Duty

We welcome the FCA's efforts to clarify firms' responsibilities across distribution chains and address industry concerns about the extent to which a firm has to understand the activities of other firm(s) in their distribution chain(s).

However, the proposed approach may not deliver significant proportionality benefits. We recognise that the FCA cannot provide an exhaustive list of arrangements that may form a distribution chain. Nevertheless, the proposals appear to treat any arrangement between firms relating to retail market business as a distribution chain.

Given the widely drawn definition of retail market business, as noted above, there are concerns about the wide range of third parties that could be brought into a distribution chain and that might therefore be subject to the Duty. This would depend on an analysis of whether one or more of the third parties could exercise material influence.

There is a risk of bringing more firms into the scope of the Duty, as well as the potential for a disproportionate application due to the inherent uncertainty of such a broad definition of retail market business and assessment of material influence.

Updating the non-Handbook guidance will be useful and we urge the FCA to work with firms on a sector-specific basis and engage relevant FCA policy and supervisory teams to develop a holistic approach to guidance that delivers a proportionate, outcomes-focused approach rather than a 'tick-box' exercise.

We support the FCA's proposals to better reflect how firms' support for consumers in vulnerable circumstances will differ depending on their role in distribution chains. The examples given in the non-Handbook guidance could include reference to situations where a firm is part of a distribution chain but does not have a direct contractual relationship with the customer. This would help illustrate how responsibilities should be allocated between manufacturers, distributors, outsourced providers and other firms involved in the customer journey.

In addition, we welcome the proposals to support firms in taking a more proportionate and practical approach when gathering and sharing information with other firms in a distribution chain, amendments to the FCA's monitoring rules to ensure they are focused on a firm's role and activities in the distribution chain, and updating the non-Handbook guidance to support firms in taking a proportionate approach to gathering information and monitoring expectations under the Duty.

These proposals should align with and inform the FCA's planned revisions to the non-Handbook guidance on board or governing body reporting. Firms consider the current reporting expectation disproportionate.

Taken together, the outcome of the reforms around gathering information, the FCA's approach to monitoring and board and governing body reporting should ensure these activities are

undertaken in a manner that is proportionate to a firm's circumstances and its actual role in influencing retail customer outcomes. This is important as some firms have suggested that the expectation for 'at least' annual reports may not reduce burdens as intended.

We encourage the FCA to provide temporary relief from, or suspend, the annual Consumer Duty Board Report requirement until the revised rules are finalised and implemented. This would prevent firms from committing significant resources to analysis that may need to be repeated once their obligations change, while supporting the FCA's objective of reducing unnecessary burden and complexity.

Chapter 5: The Duty's interaction with other product governance and disclosure requirements for retail investment products

As outlined above, the Duty's rules and non-Handbook guidance must align clearly with related requirements, for example, PROD, and the FCA should address inconsistencies in terminology. Clarity across the suite of FCA materials would reduce the risk of inconsistent interpretation, a root cause of many of the issues the FCA is seeking to address.

The proposed revisions to the non-Handbook guidance are helpful. However, members have noted that further clarification is needed on the areas highlighted above, particularly PRIN/PROD/ICOBS alignment, non-UK scope and risk location, and the new manufacturer classification framework.

In response to question 25, we do not consider that there are additional areas where the FCA should disapply PROD 3 and rely solely on the Consumer Duty. The principal challenge for firms has been uncertainty regarding how the two frameworks interact in practice.

Industry feedback has generally focused on obtaining greater clarity on the extent to which compliance with existing PROD 3 product governance obligations contributes towards meeting Duty expectations, and where the Duty is intended to impose additional or distinct requirements.

The FCA should focus on providing clearer guidance on the relationship between PROD 3 and the Duty rather than pursuing further disapplication of PROD 3 requirements.

In particular, firms should be able to place reasonable reliance on existing product governance processes, controls and assessments undertaken to comply with PROD 3, without needing to duplicate analysis, documentation or evidencing solely to demonstrate compliance with the Duty.

This approach would reduce unnecessary operational complexity and compliance costs while preserving the benefits of an established product governance framework and maintaining appropriate customer protections. It would also support the FCA's objective of promoting a more proportionate and predictable application of the Duty.

Chapter 6 Technical clarifications

The consultation paper includes several useful technical clarifications. On retail customer scope and client categorisation, the FCA should confirm when it expects to finalise the reforms proposed in the Client Categorisation Rules consultation (CP25/36). Firms have noted that a clear timeline for the implementation of these rules would provide them with greater regulatory certainty.