
Consultation Response

FCA CP22/26: Quarterly Consultation Paper No. 38

23 January 2023

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **FCA CP 22/26: Chapter 8 on the Consumer Duty**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

There are a number of remaining questions that we have regarding the Consumer Duty, that we will raise with the FCA separately.

Executive summary

Although we understand the FCA's policy objectives, AFME members wish to emphasise that it is particularly challenging to change the scope of the Duty's application in wholesale markets three months before the first implementation deadline. This will likely divert resource away from higher priority implementation items and will lead to disproportionate effort in the wholesale markets area, where there is unlikely to be material influence. Additionally, it leads to a range of interpretation difficulties and unintended consequences for "primarily" wholesale activities as set out below.

- a) **Challenges with the timeline** – AFME would like to stress the challenges that the QCP creates for firms' implementation of the new rules. While we appreciate the FCA's intention to provide clarity on certain aspects of Consumer Duty, the timeframe for this consultation is challenging, especially considering the approaching deadline of the 30 April 2023. We view the QCP proposals as material changes in scope with significant impacts on implementation projects for firms in wholesale markets (where those projects have already been signed off at board level, as required). In particular, the £50,000 exclusion changes and any changes to the scoping for occupational pension schemes will give rise to substantial implementation challenges, such as a significant re-scoping exercise and client outreach exercise a few months before the first implementation deadline.
- b) **Financial promotions** – AFME would like to note that financial promotions were not intended to be in scope for wholesale activities and firms have conducted their scoping exercises based on that assumption. The new drafting seems to cut across the primary markets exemption which is not the industry's understanding of the purpose of the change nor reflective of the way primary markets and the corporate finance advisor exclusion operate - on which AFME has previously provided comments.¹

¹ www.afme.eu/Portals/0/DispatchFeaturedImages/AFME's%20response%20to%20FCA%20CP%2021_36_Final.pdf

- c) **Definition of ‘retail customer’** – While AFME appreciates the intention to provide further clarity on the definition of retail customers, we would like to outline that outstanding questions on the interaction between the definition of retail customer and professional clients remain.
- d) **Amendments to the PS and non-Handbook Guidance** – Should the FCA proceed with the suggested changes, it is important to note that they would require amendments to the PS and the Non-Handbook Guidance, in particular in relation to their application to wholesale markets firms. This exercise would be time consuming and represents an additional challenge for the implementation timetable which was already ambitious.
- e) **AFME has some further requests for clarification which are not subject to this QCP and/ or incidental and it would like to raise these subsequently with the FCA:** these include vulnerable customer challenges in the wholesale markets (distribution chain) area and a requirement for a clearer understanding on how the £50,000 threshold applies for derivatives.
- f) **Firms would like to understand whether the FCA has had regard to HM Treasury’s 8 December 2022 letter of recommendations and to its forthcoming secondary competitiveness objective in reducing the scope of the retail market business exclusions:** Members would like to outline that the proposed scope changes seem contrary to the objective of making UK markets more competitive, as it creates an unlevel playing field for UK firms, which would be within the scope of the Duty for such clients, while overseas firms would not need to provide these additional protections; in particular, changes to the £50,000 exclusions and financial promotion requirements for wholesale firms primarily operating in wholesale markets and with sophisticated and high net worth individuals risk an unlevel playing field between overseas firms not subject to the Consumer Duty and in-scope UK licensed firms (both for UK and overseas clients). The re-scoping appears disproportionate and superfluous given the number of protections already in place for such clients, and this is an unintended consequence of a policy aimed at ordinary retail and vulnerable customer protections. Such clients would not be offered those protections by overseas firms using UK licensing and marketing exclusions cross border into the UK or operating in their home markets. The scope does not additionally help UK firm competitiveness overseas in situations where there is already sufficient protection for retail clients and the potential to conflict with prevailing local retail investor requirements for such non-UK retail investors. It may be useful for the FCA to set out its expectations and guidance on this, so that UK firms remain competitive in global markets.

1. Q8.1 – Proposal to expand the application of the Duty to firms approving or communicating financial promotions.

- AFME is concerned that the proposed clarification to the application of the Consumer Duty to retail financial promotions is unclear in relation to capital markets activities. The changes could be read to bring within the scope of the Consumer Duty financial promotions approved in the course of capital markets activities which are specifically excluded from the definition of retail market business. The promotions in question are specifically excluded from the definition of retail market business, alongside the capital markets activities to which they relate, and we do not believe that there has been a change of policy in this regard. We would therefore be grateful if the proposed new text could be amended to make it clear that it is not intended to override the exclusions inbuilt in the definition of retail market business and that, therefore, promotion-related activities excluded from the definition of retail market business remain excluded.

2. Q8.2 – Proposal to apply some aspects of the Duty to firms within the temporary marketing permissions regimes (TMPR)

- No comments

3. Q8.3 – Proposed amendments to the definition of ‘retail customer’ in the Glossary in relation to occupational pension schemes, i.e., retail customers include any person who is not a client of the firm but who is, or would be, a beneficiary of an occupational pension scheme.

- AFME members are concerned by the FCA’s approach, as it relates to markets that are fundamentally wholesale in nature.
- AFME members understand the policy intention of protecting occupational pension scheme (OPS) beneficiaries but have fundamental operational and scope questions. However, the investment managers appointed by the trustees (and trustees themselves) are best placed to offer protections and the ability and scope of wholesale market participants to materially influence end client outcomes is unclear, particularly for derivative hedges and similar transactions entered into by wholesale firms with investment managers and trustees where such managers/trustees have the opportunity to interact with various liquidity providers and have access to consumers’ information. Individual wholesale market participants do not have visibility over an occupational pension scheme’s entire portfolio and performance so cannot meaningfully consider consumer outcomes at the level of the OPS. Conversely, the operational effort and unintended consequences could be material for example:
 - the trustees would continue to be categorised as professional clients for MiFID business, but wholesale firms would be required to (a) sub-categorise some pension schemes (if material influence is unlikely) and other pension schemes (if material influence is possible) to delineate them in systems and on a transactional level; and (b) ensure the transactions are managed and recorded to the appropriate sub-account.
 - There is a risk of human error or wrong determination. The impact appears disproportionate and the real-world benefit questionable, given the role the investment manager/trustee would have in relation to the beneficiaries.
- Further, there is no industry wide classification code for OPSs for onboarding systems so any re-scoping will likely require industry wide client outreach exercises and client discussions at a late stage, for an area where wholesale firms will be challenged to explain the unclear impact and scope to trustees. This has the potential to cause market wide confusion and to divert scarce implementation resource.
- Similarly, the interplay between trustees and investment management companies (where there are requirements to have an investment manager) is complicated and inconsistent with existing requirements.
- AFME suggests that the FCA considers strengthening OPS protections via alternative means, if that is their intention. Members strongly believe that this proposal is broadening the scope without producing any of the intended outcomes. We firmly believe that the scope change is inappropriately directed in the chain. If the FCA is concerned about a smaller number of vulnerable retail customers, an easier fix would be to address that separately and specifically with the entities in the chain able to influence the protections and services offered. If the FCA proceeds with this change, we welcome

guidance on the scenarios where the FCA believes there is material influence for wholesale markets so that the industry can articulate this in outreach with trustees. Without such guidance, there is a risk of differing interpretations across the market, given that judgement will be required which introduces subjectivity.

4. Q8.4 – Proposed amendments to the definition of closed products.

- No comments

5. Q8.5/Q8.6 – Application of the Duty to non-retail financial instruments

- AFME reiterates that non-retail financial instruments should remain out of the scope of Consumer Duty.
- AFME members support maintaining the existing exclusion for non-retail financial instruments, and outline that any changes to the exclusion would be challenging considering the approaching deadline of April 2023. Firms have incorporated the exclusion as contained in the made rules into their implementation plans, and changes to the scope of the exclusion would amount to a significant expansion of the scope of the Consumer Duty. In particular, funds with a minimum investment amount of £50,000 and above would become subject to the Duty at this late stage, despite the fact that such investments are aimed at institutional and other sophisticated investors and are subject to a wide range of existing protections. AFME would welcome the opportunity to discuss this further with the FCA in due course.
- AFME would like to note that any further restriction on the ability to use the £50,000 minimum investment exclusion would again expand the scope of the Duty, which would require changes to the scope of projects (which have already been signed off at board level and which have been in progress for some time) and would require a different format of FCA consultation with greater lead time for firms to implement, and a full cost benefit analysis. Additionally, we note for example that in the Policy Statement at para 2.23 it is said that:

*We have taken account of the feedback and have amended the rules to exclude **primarily** wholesale instruments, where this will not have a negative impact on retail customers.*

Whilst in the QCP at para 8.20 it is said:

*This exclusion is intended to be used in relation to **purely** wholesale activities.*

6. Q8.7 – Clarification on the application of the Duty where an exemption applies in a sectoral sourcebook

- The proposed new PRIN 3.2.9 G is impacted by the changes made to the other provisions in PRIN 3.2 as a result of the change in scope to include the communication and approval of financial promotions. As noted above, this has led to confusing and potentially significant changes to the scoping provisions generally, including PRIN 3.2.8R. The proposed new PRIN 3.2.9 G builds on this change and adds further confusion by stating that the Consumer Duty can apply to an activity even *if a sourcebook is silent on that activity*. This is a significant change from the position set out in July 2022 when it was made clear that the scope of the Consumer Duty followed the scope of rules in the sourcebooks. We

would also point out that this guidance provision does not appear to be an accurate reflection as to how the rules work in practice. For example, the Duty applies to activities carried on with retail customers located in the UK, unless another applicable rule or regulation which is relevant to the activity has a different territorial scope (PRIN 3.3.1 R). In relation to investment business, COBS 1.1.1R and COBS 1 Annex 1 make it clear that COBS applies to the UK establishments of UK firms and, in certain circumstances, the business of overseas establishments, but only where this concerns clients in the UK. COBS does not apply to the business of overseas establishments with clients who are *not* in the UK, however this is not explicitly stated in COBS and so therefore technically COBS is “silent” on this topic. Clearly though, the intention is not to extend the territorial scope of the Duty beyond the scope of COBS, but this example indicates the fact that this guidance is not fully accurate.

- Members have raised concerns that this will be operationally challenging in practice, and obscures which clients are inside the scope and outside the scope of the Duty. This effectively creates a dual track relationship with a client requiring the firms to follow PRIN or the Duty, and risks creating confusion for the client. This is also not relevant for certain products, such as derivatives.
- Ultimately, there is a risk of banks exiting the market for particular products or client sub-sets because of the risks and cost of compliance and potential breaches in an unclear area. Conversely, overseas firms providing cross border services to clients using UK licensing and marketing exclusions (including for high net worth and sophisticated investors for marketing purposes and clients who request services via reverse enquiry) will be able to freely offer the service or product without offering the comparative protections. This will create an unlevel playing field for no clear client benefit.
- The unlevel playing field also impacts UK firms’ activities overseas and may conflict with prevailing local investor protection requirements overseas. It may be useful for the FCA to set out expectations and guidance on this, so that UK firms remain competitive in global markets.
- The current retail client definition is already broad and complex to implement at a product and services level and captures several different categories of clients. Clients are already protected by knowledge and experience assessment requirements. Firms are best placed to identify flexible support for their clients. Therefore, AFME members believe that this clarification only adds another layer of complexity to an area where firms are already working through appropriate internal assessments.

We would be very happy to talk through any of the points made in our response, with the FCA.

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