

## WHAT ARE THE GOVERNANCE AND CONDUCT RULE IMPLICATIONS OF THE NEW FCA CONSUMER DUTY?

The FCA's new Consumer Duty (the 'Duty') regime will come into effect for new and existing products and services on 31 July 2023. As part and parcel of the planning for, and implementation of, the new Duty firms need to consider the implications of the regime's new governance requirements and the addition of the new "Conduct Rule 6" to existing Senior Managers & Certification Regime (SM&CR) requirements – and how they equip their workforce.

The Duty applies to regulated financial services firms that can determine or materially influence retail customer outcomes. Its application is deliberately broad and intended to capture not just firms that directly interface with retail customers but also firms in the distribution chain that do not have a direct relationship with retail customers, if those firms can influence material aspects of the design, target market or performance of a retail financial services product or service. As a result, many firms have faced initial scoping challenges when determining the extent to which their activities are subject to the Duty. The Clifford Chance [September 2022 Briefing](#) considers the Duty rules and guidance and scope of application in greater detail.

The Duty will set higher standards of consumer protection across financial services and require firms to act to deliver good outcomes for customers. The higher standards of the Duty and the shift to focusing on consumer outcomes will require a significant change in many firms' cultures. The Duty may require firms to reconsider their approach to conduct rule breaches, senior manager statements of responsibility, fit and proper assessments, training, regulatory notifications and regulatory references amongst other matters. The FCA expects firms to have clear plans for delivering staff training, changing the culture and reviewing rewards. There is still time to do so.

This Briefing considers the governance and conduct rules implications of the Duty as well as the practical issues regulated financial services employers need to consider.

### NEW GOVERNANCE REQUIREMENTS AND A NEW CONDUCT RULE

There is a new requirement at PRIN 2A.8.1R of the FCA Handbook for the firm to ensure that the Duty is embedded in its strategies, governance, leadership, *and people policies, including incentives* at all levels; and that

#### What is the Consumer Duty?

In essence there are three elements to the Duty:

- **New consumer principle 12:** "A firm must act to deliver good outcomes for retail clients"
- **Cross-cutting rules** that require firms to act in "good faith", avoid "foreseeable harm", and enable and support retail customers to pursue their "financial objectives"
- The **"four consumer outcomes"** - a suite of other rules and guidance linked to four particular outcomes (the quality of firms' products and services, the price and value of products and services, consumer understanding and support for consumers)

#### To which firms does the Consumer Duty apply?

In broad terms to be within the scope of the Consumer Duty:

- the firm must be a "firm" as defined in the FCA Handbook (essentially, an FCA or FCA/PRA dual-regulated regulated firm)
- New Principle 12 and PRIN 2A (i.e., the consumer duty package) apply to these firms' retail market business
- Retail market business has a complex definition which can be summarised as: most regulated financial services activities and ancillary activities that are carried on for a retail customer

retail customer outcomes are a central focus for its risk and internal audit functions. Of note under the Duty:

- firms should appoint an independent non-executive director as "consumer duty champion";
- annually, the board must review and approve an assessment of whether the firm is delivering good outcomes for retail customers which are consistent with the Duty;
- every senior manager should be clear about how they are ensuring that the business of the firm complies with the requirements of the Duty on an ongoing basis;
- if a firm is required to report its own or other firms' breaches of the Duty, SMF managers should: (i) ensure the firm reports the breach to the FCA, if the matter is within the scope of the SMF manager's responsibilities; or (ii) check whether the firm has notified the matter, if the matter is outside the SMF manager's responsibilities but the SMF manager is unable to assume that the firm has notified it.

The FCA's Consumer Duty Implementation Plans [Review](#) clarifies that the Consumer Duty champion is not a "prescribed responsibility" under SM&CR. Instead, the champion's role is to support the Chair and CEO in raising the Duty in all relevant discussions and to challenge the firm's management on how it is embedding the Duty and focusing on consumer outcomes.

Interacting with the above governance piece, the Duty introduces a new Individual Conduct Rule 6 in the FCA's Code of Conduct sourcebook (COCON).

## **WHAT IS THE NEW CONDUCT RULE 6 AND WHO DOES IT APPLY TO?**

Individual Conduct Rule 6 (CR6) reflects the new, higher, standard of the Duty and the behaviour the FCA expects of all conduct rules staff. It requires all conduct rules staff to "*act to deliver good outcomes for retail customers*" where the activities of the firm fall within the scope of the Duty.

CR6 will apply to conduct insofar as it relates to retail market business whilst conduct rule 4 ('You must pay due regard to the interests of the customer and treat them fairly') will remain but be limited in application to conduct related to non-retail activity. This potentially adds a layer of complexity and uncertainty for some individuals that firms will have to address in their training, policies and procedures.

The FCA's non-Handbook Guidance states that CR6 applies to the extent that it is reasonable and proportionate: the scope of a person's job and their seniority may affect the scope of their obligations under the rule. So, the more senior a person is and the more relevant their role is to the Duty, the more the FCA will expect from them in delivering good outcomes for customers.

The FCA expects firms to provide relevant training to their staff to ensure they understand their obligations under the Duty and the individual conduct rules.

## **SENIOR MANAGEMENT FUNCTION HOLDERS (SMFS)**

In addition to the new SMF breach notification obligations (see above) the FCA non-Handbook Guidance expressly states that a firm's board is responsible for ensuring the Duty is properly embedded within the firm and

### **What is required by Conduct Rule 6 (CR6)?**

The FCA has set out three obligations that are said to be exhaustive of CR6:

- *You must act in good faith towards retail customers - Acting in good faith is a standard of conduct characterised by honesty, fair and open dealing and acting consistently with the reasonable expectations of retail customers*
- *You must avoid causing foreseeable harm to retail customers*
- *You must enable and support retail customers to pursue their financial objectives*

*“we will hold senior managers accountable through the Senior Managers & Certification Regime”.*

The FCA has also stated that evidence of an understanding of, and actions taken to comply with, the Duty will be taken into consideration when considering individuals for approval.

## **ACTION POINTS/TRICKY ISSUES FOR CONSIDERATION**

- *If the Duty applies only to the retail customer business of a firm's mixed retail/non-retail customer business what approach should it adopt in relation to conduct rule training/reporting/etc?*
- *Is it appropriate to adopt a blanket application of the Duty (i.e. treating all staff as though CR6 applies to them) or will this be problematic and give rise to confusion (for example, in respect of regulatory notification for breach)?*
- *How should the fundamental cultural shift that underpins the Duty be reflected in training, contracts, handbooks, people policies, and approach to incentive adjustment and disciplinary action? Some roles will involve a mixture of "retail market business" caught by the Duty and CR6 with other activities technically out of scope. How should firms address this in practice in terms of training, reporting of breaches and so on? Is an all-staff or tailored training approach going to be more effective?*
- *How should individuals caught by CR6 interact with individuals only caught by CR4?*
- *Conduct rule 6: how should firms determine what is a reasonable and proportionate application of CR6?*
- *Conduct rule breach reporting: ordinary conduct rule breach requirements apply to breaches of CR6 including reporting obligations. Internal policies and processes will need to be amended to address this.*
- *People policies: what policies should a firm review and update to take account of the new regime: disciplinary, speak up, training etc?*
- *Do staff have a clear avenue to raise concerns if they feel the firm is not delivering good customer outcomes combined with a mechanism that those issues are picked up and addressed expeditiously by management?*
- *How can a firm ensure that staff understand the consequences of not complying with the Duty?*
- *Fitness and propriety assessments: the FCA has specifically stated that evidence of an understanding of, and actions taken to comply with, the Duty will be taken into consideration when considering individuals for approval. Will it also be appropriate for firms to import this into their own fitness and propriety assessments?*
- *Regulatory references: to what extent will CR6 breaches need to be reflected in regulatory references and do internal processes need to be adjusted to ensure this is addressed?*
- *Additional reporting considerations: How will the new SMF reporting obligations be addressed internally?*
- *Statements of responsibility – do these require updating, e.g. for the consumer duty champion and/or SMFs more generally?*

- *Incentives*: to what extent do incentive arrangements need to be refined to address the new Duty?

[Clifford Chance Briefing on the Consumer Duty 7 September 2022](#)

[FCA Final Guidance FG 22/5](#) FCA Policy Statement [PS 22/9](#) (July 2022)

[FCA Consumer Duty Implementation Plans Review](#) (25 January 2023)

FCA Webpage: [Consumer Duty – information for firms](#)

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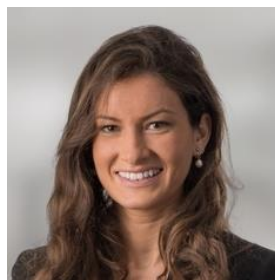
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