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The FCA's renewed focus on suitability & TCF

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21 January 2014

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Looking at …

1. How the FCA is supervising conduct issues
2. What the FCA is looking at
    a) Business model
    b) Strategy
    c) Governance
    d) Culture
    e) Incentives
    f) Design
    g) Distribution
    h) Information
    i) Fair treatment
3. How does the FCA scrutinise for suitability?
4. The FCA's current challenges on suitability

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1. How the FCA is supervising conduct issues

… the FCA will be behaving differently from City watchdogs of the past. We won’t be captured by rulebooks and procedure. We’ll be far more focused in future on the consumer. **Putting the customer at the heart of everything** we do, and expecting the same attitude from firms.

Martin Wheatley March 2013

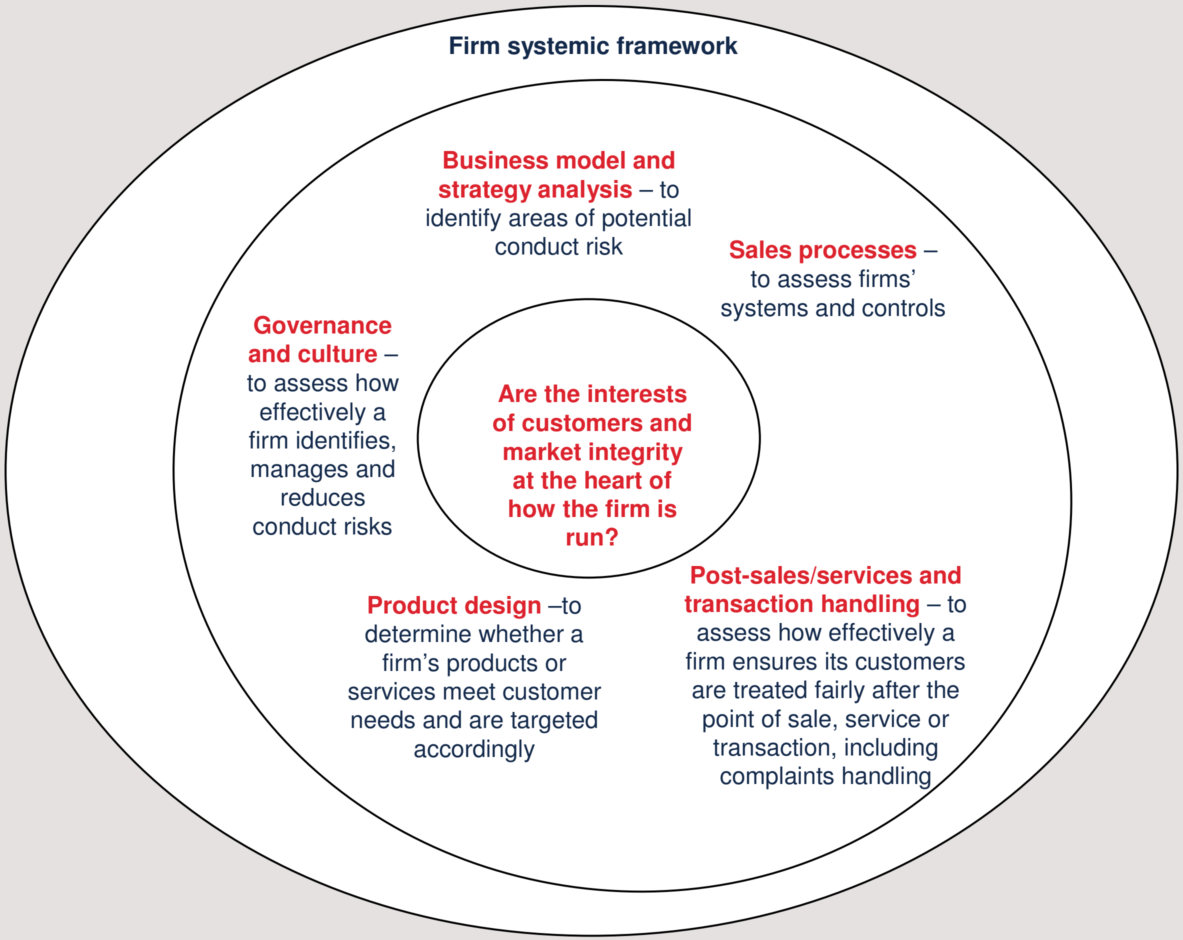
The FCA approach to supervision

The new **Firm Systematic Framework** is designed to answer the key question of 'Are the interests of customers … at the heart of how the firm is run?' and will involve:

- analysing firms' **business models and strategies**
- an assessment of how the **fair treatment of customers** … is embedded in the way in which the firm runs its business

Clive Adamson March 2013

The FCA firm systemic framework



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2. What the FCA is looking at

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a) Business model

i. Revenue by area
ii. Profit by area
iii. Income by channel
iv. Customer segmentation & experience
v. Resource strength & capabilities

- What about the value chain?
- Is there subsidisation?
- What about exploitation of the client base – charge extraction?

b) Strategy analysis

i. Assessment market & trends
ii. Key profit drivers & constraints
iii. Targets
iv. New activities
v. Growth & withdrawal
vi. Distribution & customer strategy

– How does this affect your customer services?

c) Governance

i. How is risk identified
ii. And managed
iii. What MI goes to senior management
iv. Show us how it is acted upon
v. How does the firm take conduct issues …
vi. … and ensure that the customer is at the heart of the business?

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d) Culture

The risk …

… firms adopt strategies that **support their own interests** but may not be in the long-term interests of their consumers …

The requirement – clarity on …

- Revenue drivers
- Clear business practices
- Tone from the top
- Remuneration
- Dealing with issues
- Actual customer experience
- Looking at outcomes

e) Incentives

The risk …

We are concerned that **reward culture is contributing to mis-selling** …we have found that **most incentive schemes** that we looked at are likely to drive mis-selling, and this risk is not being properly managed

If you do have an incentive scheme, it has to be structured and managed in a way that **treats the people it will affect fairly**.

Martin Wheatley September 2012

The requirement …

i. Identify and record all incentives
ii. Map the risks and the mitigants
iii. Consider the governance of incentives
iv. Review from a TCF perspective
v. Change the objectionable features

f) Design

The risk …

Products and services that are **not designed in response to real consumer needs** may be unnecessarily complex or lead to excessive prices for consumers or reduced access to financial services

FCA Financial Risk Outlook

The requirement …

i. Meeting a demonstrable need
ii. Fully understood profile
iii. Stress tested
iv. Trial marketed
v. Literature clear
vi. Distributors trained
vii. Distribution monitored
viii. Performance monitored

g) Distribution

The risk …

... Across complex distribution chains, **firms may fail to take on conduct responsibilities** e.g. ensuring TCF principles are adhered ... on the assumption that these have been taken care of at previous stages in the transaction.

… **an adviser may assume that the product originator and/or distributor** have ensured that the product offers value to the consumer, that performance credentials are realistic and that downside risks are clearly articulated.

FCA Financial Risk Outlook

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The requirement …

i. Select
ii. Document
iii. Train
iv. Monitor
v. Challenge

h) Information

The risk …

Consumer detriment has repeatedly arisen where consumers have bought **unsuitable, deceptive or overpriced products or services** …

Many poor consumer outcomes in financial markets stem from **incomplete availability, disclosure or understanding of information** on the features or likely performance of financial products and services.

FCA Financial Risk Outlook

The requirement …

i. Is it clear?
ii. Is it fair?
iii. Is it not misleading?

i) The wider TCF requirement

The six retail TCF outcomes remain core with an overlay …

i. Governance
ii. Senior management
iii. HR
iv. Getting and acting on the MI
v. Evidence

The six retail TCF outcomes in 2013/14 …

1. Giving consumers confidence that TCF is core
   - Remuneration, training, tone, senior management
2. Carefully designing products
   - Research, target, design, listen
3. Keeping customers informed
   - Panelling, testing, listening
4. Any advice is suitable
   - Mystery shopping, checking, call listening, welcome calls
5. Products perform as expected
   - Measuring, comparing, analysing, RCAing
6. Making it simple to switch, claim or complain
   - Deliver the service, review the blocks

3. How does the FCA scrutinise for suitability?

The suitability pulse …

1. Quality of oversight
2. Fairness of marketing
3. AML on inception and afterwards
4. Ongoing KYC
5. Delivery of the promised service
6. Record keeping
7. Identifying and managing conflicts

Causes of un-suitability

Generators of unsuitability

1. Risk profiling tools with complex and limited questions
2. Unclear customer risk category descriptions
3. Failing to confirm customer's level of risk was correct
4. Failure to gather necessary information
5. Inaccurate information or in appropriate use of sales aids
6. Unstructured or overridden process
7. Firm may not fully understand the risks

Resulting in

=> Failure to make suitable recommendation

a) Over invested

b) Over concentrated

c) Wrong duration

d) Wrong linked assets

=> Not match risk prepared to take

FSA Quality of investment advice in retail banking (Feb 2013)

The remedies …

Fundamental requirements

a) Fully understanding the offering
b) Strong front office controls
c) Good training
d) Proper business monitoring
e) Compliance monitoring
f) Flow of management information
g) Senior management engaged
h) Alert to changing market

Point of sale

a) Accurate product material
b) Full know-your-customer
c) Importance of attitude to risk
d) Full record of the facts
e) Clear customer communication
    i. Facts
    ii. Rationale
    iii. Risks
    iv. Recommendation
    v. Taking into account full requirements

4. The FCA's current challenges on suitability

Looking at …

- What goes wrong?
- How does a suitability issue arise?
- What will FCA want to know?
- What action might FCA take?
- How can you satisfy FCA and put things right?

What goes wrong?

1. Failures to carry out due diligence on a product
2. Failure to gather/record full client information – soft and hard facts
3. Failure to correctly establish or record ATR
4. Unclear risk descriptions or inadequate risk profiling tools
5. Mismatched investment horizons
6. Inadequate asset allocation tools
7. Replacement business
8. Shoehorning
9. Failure to address needs of vulnerable clients
10. Failure to update factfinds/KYC
11. Inadequate/misleading suitability letters
12. Failure to monitor advice/file reviews
13. Failure in MI …

= Breaches of FCA Principles 6,7, 9 and 3

Identifying a suitability issue

Usually by:

- FCA Thematic visits
- FCA Supervisory visits
- Responding to FCA communications eg Dear CEO letters
- Business/compliance monitoring
- Complaints analysis

- You must respond promptly and provide reassurance that issues will be addressed.

What will the FCA want to know?

1. How did the issue arise? Was it a failure in systems and controls?
2. Explain your advice processes?
3. How many clients might be involved?
4. Is it limited to certain products, types of client or advisers – how can you be sure?
5. Why was it not picked up by monitoring/ business checks?
6. What training do advisers receive?
7. What information is provided to client?
8. What MI – should this have identified the issue earlier?
9. How are you going to remediate? What action has management been taking?

– You must satisfy FCA you understand the issues and are putting it right

What action can the FCA take?

1. Intense Supervisory contact
2. S166 Skilled Person Report
3. Refer to Enforcement for investigation
   a) Fines and publicity
   b) Individual action against senior management
4. Past business review and redress
5. OIVOP – prevent take on new clients
6. Attestations on remedial action
7. Private warnings
8. Consumer redress for widespread failings

"…our recent cases have underlined that we are more committed than ever to showing firms and individuals that they must play by the rules; because if they don't, robust sanctions are a matter of course."

Tracey McDermott October 2013

How to avoid?

- Robust and effective systems and controls
- The "remedies" slide
- And if issues arise ……..
- Constructive engagement with FCA Supervision
- Considered responses to FCA correspondence
- Seek to retain the initiative and stay in control
  - Act promptly
  - Scope remedial action/redress
  - Offer past business review
  - Retraining and adviser issues
  - Demonstrate senior management engagement
  - Regular reporting to the FCA on progress
- Obtain quasi s166 Report or independent oversight to firm's remedial actions

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So in summary …

- FCA has an increasingly broad supervision agenda
- Customer outcomes are centralised
- Suitability is nested in a host of other issues
  - Governance
  - Incentivisation
  - Distribution chain
- TCF is reinvigorated as a central doctrine
- The FCA is focussed on disadvantage – and exposure to it
- There are clear steps firms can take to avoid Enforcement and manage if it happens