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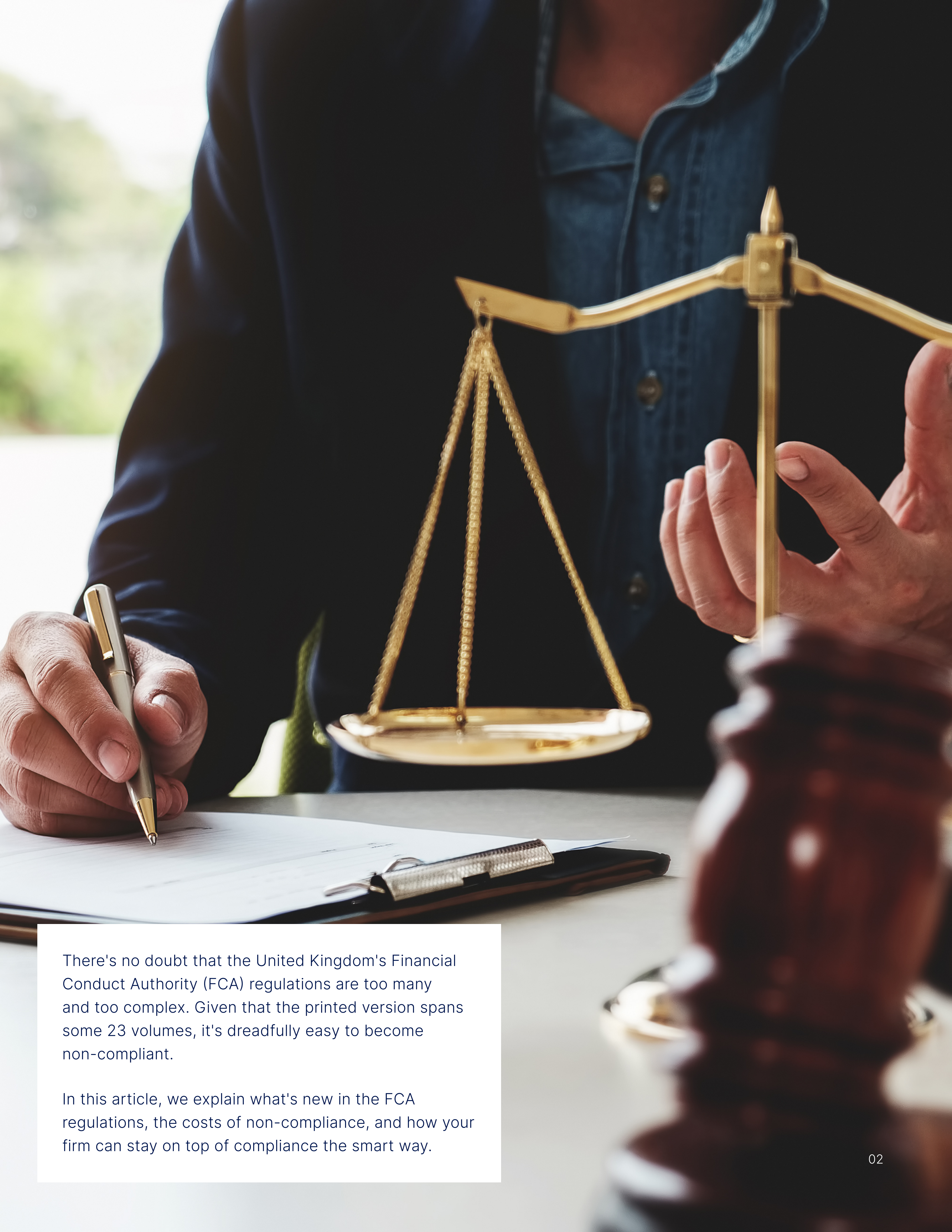
Complying With FCA Regulations and Consumer Duty in 2023

What are FCA regulations and how do you stay on top of them?
Find out below.



There's no doubt that the United Kingdom's Financial Conduct Authority (FCA) regulations are too many and too complex. Given that the printed version spans some 23 volumes, it's dreadfully easy to become non-compliant.

In this article, we explain what's new in the FCA regulations, the costs of non-compliance, and how your firm can stay on top of compliance the smart way.

What Does the Financial Conduct Authority Do?

The regulatory framework for financial firms in the United Kingdom (U.K.) consists of two agencies:

- The Prudential Regulation Authority (PRA)
- The Financial Conduct Authority (FCA)

The PRA, reporting to the Bank of England, supervises the financial situations (i.e., prudential supervision) of about 1,500 large financial institutions critical to the U.K.'s economy, including banks, insurance, and investment companies.

In contrast, the FCA reports to the Treasury and supervises the business conduct of some 50,000 financial firms of all sizes, including large institutions. It also prudentially supervises the finances of about 48,000 of them that aren't PRA-regulated, protects consumer interests, and ensures healthy financial markets. Every financial firm in the U.K. must be authorized by the FCA.

Overview of FCA Regulations

Let's review some of the FCA regulations for different aspects of the financial services industry and their recent amendments, if any.

Authorization for Firms

The list of regulated activities includes:

- Insurance and related activities like underwriting
- Banking
- Home and real estate mortgage
- Retail and wholesale investments
- Credit activities of credit unions, lenders, and borrowers
- Claims management

A new firm that wishes to enter any of these sectors must apply for authorization and get the appropriate permissions from the FCA. There haven't been any recent changes in these aspects.

Future Regulatory Framework

The future regulatory framework will overhaul the regulatory requirements on financial firms as proposed by the financial services and markets bill that's under review and may become law in 2023.

Senior Management Responsibilities

The FCA's third principle requires robust risk management and internal controls. As part of that, it requires firms to assign clear responsibilities to the senior management and board of directors on aspects of interest to the FCA.

The definitions of senior managers and certification regime (SMCR) firms were slightly amended recently in February 2023.

Environmental, Social, and Governance (ESG)

From 2022, the FCA requires firms to report climate-related impacts and risks as part of ESG and sustainability initiatives.

- Code of conduct for all suppliers, warning them about the use of forced labor
- Independent verification and monitoring reports
- Details about all the suppliers in the chain
- Purchase orders, receipts, and other standard accounting documents
- Mining and production orders

Reporting

Firms must submit annual reports and follow other reporting requirements laid out in the supervision section.

Investments

The FCA lays out disclosure requirements and rules for aspects like client asset management. In 2022, the FCA issued special rules related to investments affected by the Russia-Ukraine conflict, and they're likely to stay in force well into 2023 too.

Credit Industry

Speaking of the conflict, the U.K. is experiencing higher energy prices and cost of living because of it. Noting this, the FCA decided in late 2022 to start collecting consumer credit data from regulated firms to track inflation and higher cost of living over longer time frames.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FCA Consumer Duty — A Major New Regulation for 2023

Many financial services firms harm retail consumers through bad-faith practices like misleading them or selling unsuitable financial products. Recognizing this, the FCA will enforce the consumer duty, a consumer protection standard that aims to reorient the entire culture of firms toward consumer interests. The consumer duty is likely to be the regulatory development with the widest impact on the U.K.'s financial sector this year and in the future.

Key Elements of the New FCA Consumer Duty

The new consumer duty consists of the new customer principle, three cross-cutting new rules, and four concrete outcomes.

New Consumer Principle

The new overarching principle 12 — a firm must act to deliver good customer outcomes — prescribes a higher standard of conduct than principles six and seven among the existing principles.

Three Cross-Cutting Rules

To support the consumer principle, the consumer duty prescribes three cross-cutting rules for financial firms:

- Act in good faith with honesty, fairness, and alignment with customer expectations.
- Avoid causing foreseeable harm to retail customers through their actions or omissions.
- Enable and support the financial objectives of customers.

Four Outcomes

The consumer duty prescribes four sets of objective customer outcomes guided by the consumer principle and cross-cutting rules:

- Product and service outcomes
- Price and value outcomes
- Consumer understanding outcomes
- Consumer support outcomes

Penalties for Breaching the Customer Duty

The FCA made it clear in its policy statement that it'll actively detect and uncover misconduct starting July 31, 2023. Based on precedent, it'll follow the FCA handbook's penalties and enforcement rules that may include stopping further sales, imposing fines, disciplinary action against senior managers, or even criminal prosecution.

Top Compliance Measures for Financial Firms

Before going into consumer duty implementation measures, be aware of four critical regulatory milestones:

- **July 2022**: Open products — that is, existing products on sale or renewal and upcoming products — get a year to plan for these rules. Closed products that are no longer sold as of July 2022 get two years.
- **April 30, 2023**: Firms that create or design financial products must be fully prepared to meet the outcome rules and advise their distributors that sell, offer, or recommend their products.
- **July 31, 2023**: For open products, the implementation planning period ends and enforcement starts.
- **July 31, 2024**: For closed products, the planning period ends and enforcement starts.

Based on the outcomes and consumer duty rules in the final rules for regulated firms, here are our top compliance recommendations:

- **Include consumer duty in your business plan:** New firms must embed customer duty principles in the business plan they submit to the FCA for authorization.
- **Align your financial services with consumer interests:** Avoid creating or selling products that aren't aligned with the objectives of your retail clients. Avoid conflicts of interest, like misaligned incentives for your employees, that may harm your customers' needs.
- **Provide fair value for your products:** Ensure that your products meet reasonable expectations and deliver fair value.
- **Communicate honestly:** Ensure that your product features, risks, and financial outcomes are communicated to consumers.
- **Provide lifetime customer support:** Ensure that you give your consumers support for their purchased products throughout their customer journey.
- **Monitor consumer outcomes:** Monitor the outcomes your products are providing to your customers and modify them when necessary.

Case Studies of Non-Compliance With FCA Regulations

The FCA publishes the progress of all their investigations in various notices. Among them, final notices explain the actions the regulator is taking, and second supervisory notices list the actions the regulator has taken after a final notice. By studying them, you can get insights into FCA's investigation and enforcement actions, and plan preventive measures.

Two case studies of non-compliant insurance firms demonstrate how the FCA regulates business conduct.

UK's Second-Largest Home Insurer Fined £90 Million for Misleading Customers

Lloyds Bank General Insurance (LBGI) is the U.K.'s second-largest home insurer. In 2017, it accounted for 12.29% of all home insurance policies, earning more than £700 million in premiums from 18 million contracts.

On investigating LBGI's fine print, the FCA found that their claims about competitive prices and discounts on renewals were misleading. They had also failed to review the accuracy of their claims or assess customer outcomes. The FCA decision committee concluded that LBGI had neglected principles three and seven on risk management and client communications, and fined them more than £90 million.

Plus, the FCA overhauled the entire insurance ecosystem by mandating that renewal prices can't be above the prices for new customers.

Insurance Intermediary Mishandles Insurance Premiums and Goes Down

An insurance intermediary is a firm that introduces, negotiates, or implements insurance contracts on behalf of an insurance company. Larksway was one such firm that negotiated insurance policies for its clients. However, it failed to pass on nearly £320,000 in insurance payments to an insurance provider. It also defaulted on payments of about £52,000 to another firm. When asked for details by the FCA, Larksway didn't provide the requested information.

In response, the FCA ordered Larksway to stop its insurance services, canceled its FCA authorization, and ultimately liquidated the firm.

Key Takeaways from the Case Studies

The case studies above present some contrasts. One was a small firm that indulged in outright fraud and was rightly taken down. The other was a reputed large firm that had been negligent and later cooperated with the regulator. Even though misleading terms in the fine print and false advertising are common tactics by businesses, the FCA doesn't ignore such practices. Instead, it used its principles to make an example of a reputed firm that should have known better.

5 Strategies to Minimize FCA Non-Compliance Risks

Given the breadth and depth of FCA regulations, it's a good idea to have overarching strategies to guide business conduct across your entire organization. Here are our top five strategies to minimize the risks of FCA non-compliance across the board:

Model your business ethics on the 12 principles

The 12 principles in the FCA handbook strive for higher integrity, accountability, and trust. Explicitly adding these principles and values to your plans — and including business ethics officers as reviewers at all levels — will make compliance a habit and not just an afterthought.

Design a fool-proof code of conduct for your organization

Ensure that your code of conduct percolates through your entire organization, from top management down to all employees, and guides all their business activities.

Let risk management influence all your business plans

Use robust, standardized risk management principles across your entire organization to foresee and mitigate regulatory risks.

Follow impeccable financial practices

Follow the highest standards in your accounting, auditing, and documentation practices to prevent and detect intentional or unintentional non-compliance.

Build compliance into your recruitment and training

Get the right people with the right attitudes and train them well to ensure built-in compliance at the organizational level. Prevention is often better and cheaper than cure!

How Certa Helps With FCA Compliance

When faced with thousands of rules, the smart way to ensure compliance is through automation.

Certa's risk management, contract templates, and workflows enable you to integrate FCA rules into all your processes, business activities, and agreements. With enhanced due diligence, ensure that all your third parties are vetted and remain compliant with your policies & procedures, as well as evolving government regulations.

Moreover, Certa's integrated e-learning conveniently offers FCA compliance training and rules in the system so that your internal and external users never have to leave Certa's platform.

Talk to our experts to see how Certa can help you with your FCA compliance measures.