

## In Practice

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# The FCA's new consumer duty could affect FCA regulated investors in asset backed financings of products offered to retail customers

The policy statement and final guidance on the consumer duty published on 27 July 2022 by the UK's Financial Conduct Authority (FCA) set out a new Principle for Business for regulated firms, new cross-cutting rules and detailed expected outcomes that these rules and the new principle should have on retail customers (together the "Duty"). The Duty has multiple implementation stages with the key dates being: (i) 31 July 2023, when the Duty will apply to all new products and services and existing products and services that are open to sale or renewal; and (ii) 31 July 2024, when the Duty will extend to all closed products and services.

This article explores some practical considerations for FCA regulated investors in asset backed financings of products offered to retail customers (Investors) when determining whether the Duty applies to them.

### WHAT IS THE NEW PRINCIPLE?

The Duty adds a new principle, Principle 12, to the existing FCA Principles for Business, which states that:

"A firm must act to deliver good outcomes for retail customers."

This principle represents a significant departure from the current position in which firms are generally obliged to avoid poor outcomes for customers, by introducing a positive obligation to deliver "good" outcomes. What "good" outcomes look like very much depends on the type of business, the type of customer and the extent of the ability of Investors to influence these outcomes.

### WHO IS WITHIN SCOPE OF THE DUTY?

In addition to applying to all FCA regulated firms that directly face retail customers, the Duty also applies to regulated firms in a "distribution chain" that do not directly face customers but are in a position to determine or materially influence retail customer outcomes; for example, where such regulated firms influence aspects of the design, target market or performance of a retail financial services product or service or determine how to collect non-performing loans or design customer communications.

As a result, Investors that fund products, including mortgage loans, consumer loans (either secured or unsecured loans) or any other form of consumer receivable (a Product) may fall within the scope of the Duty.

### WHAT DETERMINES WHETHER THE DUTY APPLIES TO INVESTORS?

The Duty will likely apply to any Investor that has funded Products and either becomes the legal title holder of such Products (thereby directly facing customers), or to an Investor whose position grants the right to determine or materially influence outcomes for customers.

In deciding whether an Investor has the right to determine or materially influence outcomes for customers, an Investor should consider the rights afforded to them as part of the financing, rights which, when exercised, impact outcomes for the end borrowers. For example, the Duty may apply if an Investor:

- can unilaterally amend key financial terms (including the interest rate) of the Product;
- has a right to sign off on such changes;
- is able to request a repayment or cause a payment to be requested from the customer; or
- can cause any of the policies, procedures and general framework concerning the product and/or its key features to be amended.

### WHAT SHOULD INVESTORS DO IF THEY DETERMINE THAT THE DUTY APPLIES TO THEM?

Where it has been concluded that the Investor's activities are within scope of the Duty, the Investor should explore, amongst other considerations, whether the financing documentation should be changed so that the Duty does not apply (such as by reducing the level of the Investor's control over the underlying Products), or – if the Investor wishes to retain the rights that bring the Investor within the scope of the Duty – implementing a Duty compliance framework that will set out how the Investor complies with each applicable aspect of the Duty.

In addition, the FCA provides guidance on situations in which an unregulated special purpose vehicle (SPV) purchases a book of consumer receivables, including guidance that obligations of

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professional due diligence in the Consumer Protection from Unfair Trading Regulations 2008 may apply. The FCA takes the view that the Duty is relevant to the due diligence the SPV carries out in the discharge of these obligations, so if an Investor has control over the SPV, the Investor should consider how any due diligence process approaches compliance with the Duty.

If the Investor purchases a book of Products as legal title holder, the Investor should ensure that it has the requisite regulatory authorisations and request from the selling firm all relevant information to enable the Investor to comply with the Duty. The FCA provides specific guidance on how regulated firms should approach such purchases.

### HOW DOES THE FCA ENFORCE THE DUTY?

The FCA imposes a “comply or explain” standard for enforcement, such that the FCA expects any entity that falls within the scope of the Duty to self-assess the applicability of the Duty, failing which the FCA may request an entity to provide evidence of its compliance.

Any firms that fail to comply with the Duty by the relevant dates are required to notify the FCA pursuant to Principle 11 (*Relations with regulators*), and the FCA’s usual enforcement powers are available for breaches of the Duty, including a fine, public censure and consumer redress.

Unusually, the Duty also places an obligation on firms to notify the FCA of any breaches of the Duty by other parties in the same distribution chain and requires firms to notify other firms in the distribution chain if the notifying firm thinks another firm has caused, or contributed to, harm to retail customers. This obligation may be relevant to the outcome of any Investor due diligence conducted.

As the Duty comes into force, Investors should consider how it applies to them and to their investments so that, if the Duty does apply, Investors can take appropriate steps to ensure ongoing compliance with their regulatory obligations. ■

#### *Biog box*

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