THE
INVESTMENT
ASSOCIATION

Response to FCA Call for Input:

Review of FCA requirements following the introduction of the Consumer Duty

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The Investment Association (IA) welcomes the opportunity to respond to the FCA's Call for Input ("CfI") on its review of FCA requirements following the introduction of the Consumer Duty. The IA views this as an important exercise and a potential opportunity for industry, policymakers, and government to collaborate on building a regulatory architecture that is match fit for the future. At the same time, we see the CfI as part of a process of dialogue, reflection and optimisation that will require some time to fully realise.

There are three key reasons for this long-term focus. First, the scale of the project is significant. We agree that the FCA Handbook and its body of rules and guidance is overly complex and unwieldy, and meaningful simplification and modernisation could lead to benefits for consumers, regulated firms and the wider economy. We do not seek change for change's sake, and this should not encompass a one-off exercise. We consider that a comprehensive review is required which will allow for proper consideration and analysis. Such an exercise and the implementation of any subsequent changes will demand resources, which will need to be carefully balanced with the perceived benefit for consumers and industry.

Second, at the time of this publication, the final implementation deadline for Consumer Duty has only recently passed, with firms continuing to embed the Duty into day-to-day activities, the first round of Board Reports newly produced and ongoing FCA work reviewing how firms have implemented the Duty. The industry is also grappling with complex initiatives, notably the Sustainability Disclosure Requirements (SDR) and investment labels regime, a major intervention that has placed significant demand upon firms' resources across all areas including compliance, operations, legal, product development and marketing.

Third, we await a series of major pieces of work, notably the Consumer Composite Investments (CCI) regime, the outcomes of the Advice/Guidance Boundary review (AGBR) and the review of the Handbook

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requirements for AIFs, which are integral to the Consumer Duty. We welcome the progress being made in these areas, and we hope that some of the simplification we need will be addressed here.

For now, we have therefore taken a non-exhaustive thematic approach, presenting high-level initial suggestions for change and identifying areas of the Handbook where changes are likely to have the greatest impact. In some areas, there is not yet an industry consensus on the way forward and further discussion will be needed as part of a longer-term process.

Our response is broken into five parts:

Part One outlines our vision for a regulatory framework that delivers against established FCA statutory objectives, while supporting a new emphasis on competitiveness. It is based on six industry objectives that we have previously put forward:

- Target regulation effectively
- Calibrate risk appropriately
- Stimulate innovation and growth
- Focus on the cost of doing business
- Facilitate cross-border business
- Modernise the regulatory process.

We emphasise how the layering of requirements is having an adverse impact on the industry and how recent regulatory initiatives raise important points about effective targeting of regulation.

We advocate for a new approach to risk, which enables and stimulates innovation as well as boosting financial returns for millions of long-term savers and investors.

We are encouraged by recent FCA statements and activities in this area, particularly the work on technology, and look forward to collaborating further.

Part Two identifies two key areas that we consider will benefit from simplification and streamlining alongside the important reforms ahead on retail disclosure and advice/guidance provision:

- Value assessment regulations in the retail market, particularly public reporting requirements for COLL AoV.
- Setting a clearer demarcation between retail market regulation and the wider institutional market.

Part Three sets out a series of principles for a review of the Handbook. The starting point should be a clear statement of regulatory expectations in one place to ensure that parties are fully aware of the expectations that apply to them. The principles focus on:

- *Rationalisation* of the Handbook, with a particular emphasis on the need to address the wide range of FCA expectations beyond the Handbook, in the form of guidance, speeches, thematic and multi-firm reviews and Dear CEO letters.
- *Modernisation* of the COLL and CASS sourcebooks, to facilitate areas such as Direct2Fund proposals, streamline the change management process, improve outcomes for legacy unitholders and allow a meaningful expansion of the Dormant Assets Scheme.
- *Simplification* to address areas such as client categorisation rules, financial promotion rules and overlapping regimes with the Duty, including risk warnings, product governance, Treating Customers Fairly (TCF) and the client's best interests rule.

Part Four responds to selected questions posed in the CfI. We outline key considerations related to the question of outcomes-based regulation versus prescriptive rules, noting that the former is still very much in its infancy and that there is no clear choice to be made between the two. Instead, a nuanced approach is needed based on the specific objectives of different aspects of regulation.

We highlight several specific areas where we see ambiguity and a lack of clarity in Consumer Duty requirements:

- Vulnerable customers and the issue of proportionality
- The Distributor feedback loop requirement

We also note members' views in relation to the alignment of the Handbook with international, particularly EU, requirements, in order to balance the opportunity for regulatory reform with the desire for ongoing interoperability as far as is possible.

Part Five concludes with a recommendation, calling for the creation of an Investment Management Regulatory Forum/working group(s) to foster a dialogue between industry and regulators, promoting a more collaborative approach to policy development and prioritisation for the benefit of consumers.

We expect that some of the points raised within our response will be familiar to the FCA, due to their connection with longstanding areas of interest raised during previous engagement with the regulator.

We would be happy to discuss our response further with the FCA and look forward to continuing this important dialogue.

Part One: Our vision for a regulatory framework fit for the future

The IA has worked closely with its members and policymakers to shape the future of the industry since the UK's referendum on leaving the EU in 2016. We have presented our views and thoughts throughout that time through a series of communications, including the 2019 UK Funds Regime Working Group report[1], our response to HM Treasury's UK Funds Regime Call for Input[2] and response to the FCA Discussion Paper 23/2: Updating and improving the UK regime for asset management[3].

We also acknowledge the ongoing workstreams related to the Smarter Regulatory Framework (SRF), the listings reforms and wider rule review process begun by HM Treasury and the FCA. We continue to engage closely with policymakers on these files which fall outside the scope of our response.

Our vision

The investment management industry aims to create an optimal regulatory framework that delivers against statutory objectives, while fostering innovation and supporting the FCA's new secondary objective of enhancing the UK's international competitiveness. In our response to DP23/2, the IA and its members outlined a vision aimed at maintaining the competitiveness of the UK investment management industry. We advocate for maintaining a primary focus on these six regulatory objectives as listed below to guide our policy and regulatory strategy. These objectives are equally relevant in this context.

- **Target regulation effectively**: Applying over-broad regulation, with insufficient targeting, increases costs and fails to deliver benefits to end-consumers. Regulation should target areas where a specific harm has been identified. Regulation designed to solve a problem in one sector should not be applied to all sectors and within the asset management industry. Rules must consider the differences between products/services provided to retail and institutional clients.
- **Calibrate risk appropriately**: The culture and regulatory framework must recognise the benefits of risk and accept that not all risk can and should be eliminated. Efforts to remove all risk can lead to poorer outcomes, as consumers may avoid partaking in capital markets.
- **Stimulate innovation and growth**: The regulatory regime must enable and promote innovation in processes, products and beyond, reflecting the transformational potential of recent technological advances. Innovative products and services enable growth.
- **Focus on the cost of doing business**: The cumulative cost of doing business must remain proportionate to avoid hindering development of the industry to the detriment of consumer and discouraging firms from locating business in the UK.
- **Facilitate cross-border business**: Our industry is cross-border in nature and the regime must support firms to continue and expand the cross-border delivery of products and services, whether through delegation or the import and export of products and services.
- **Modernise the regulatory process**: Processes for forming and implementing regulation need to enable better and more interactive collaboration with practitioners and other stakeholders. Modernisation should also include a formal process for a thorough examination of existing regulation as the FCA moves towards more outcomes-focused requirements.

We elaborate on several of these aspects below:

Effective targeting of regulation and focus on costs of doing business

We agree that simplifying the Handbook can help reduce regulatory compliance burden and complexity for firms. A longstanding concern held by industry relates to the cost and complexity created by the layering of new regulation onto similar existing requirements. Over the past decade, the UK has seen an

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[1] IA UK Funds Regime Working Group: Final report to HM Treasury Asset Management Taskforce, The Investment Association, 2019.

[2] Response to HMT Review of the UK Funds Regime Call for Input, The Investment Association, 2019.

[3] Response to DP23/2: Updating and improving the UK regime for asset management, The Investment Association, 2023.

unprecedented level of significant new regulation affecting the asset management industry. Examples include rules derived from the remedies set out in the Asset Management Market Study (AMMS); implementation of MiFID II; Senior Managers & Certification Regime (SM&CR); LIBOR Transition; Consumer Duty; Taskforce on Climate-related Financial Disclosures (TCFD) and SDR.

The industry has embraced and adapted to these changes, in the interests of driving efficiency, raising standards of governance and oversight and thereby improving the outcomes for our customers across the market. However, the layering of requirements is having an adverse impact on the investment management industry, creating a compliance burden that suppresses innovation and prevents UK-based firms from reinvesting in their businesses, making the UK a less attractive place to conduct business and ultimately stifling growth in the process. The removal of unnecessary compliance costs is an important step toward reducing the overall cost of doing business.

With respect to the introduction of Consumer Duty and new outcomes-based regulation, the industry would have welcomed a review of detailed rules for potential removal from the Handbook. Instead, we have seen an approach that has introduced new rules on top of existing ones, creating complexity for the market without assessing consequences. The FCA has chosen to introduce rules disapplying Consumer Duty requirements (examples include Principles 6 & 7 and PRIN 2A.3.24R), rather than removing existing duplicative requirements. The overlay of broad, principles-based rules on top of similar, prescriptive rules within the Handbook has resulted in a lack of regulatory certainty which makes it harder for firms to determine clear standards for compliance. Clearly, the CfI is in part intended to rectify this, but there need to be lessons learned that go beyond rectification. In particular, both Consumer Duty and SDR raise important process points about effective targeting:

- Consumer Duty introduced responsibilities in key areas that were analogous but framed differently to existing requirements for in-scope business. This is most notable with respect to COLL Assessment of Value (AoV) as compared to Consumer Duty Fair Value. As we note later in this response, the new DC pensions Value for Money Framework consultation is about to do this for a second time.
- SDR was developed in a manner that appeared to disregard existing market norms and current fund strategies in the name of a clarity that does not reflect how investment in this area often works. While the industry is still aligned with the overall objectives of SDR and committed to high standards of disclosure, both the final Policy Statement and implementation process have raised significant questions about how policy change in novel areas should be undertaken and the balance between principles and prescription. It is crucial that when drafting FCA rules, those rules are tested with real fund examples before they are finalised and the FCA's interpretation of the final rules also needs to be clear to industry. The FCA should not refrain from a second consultation round with the market where this will lead to a smoother implementation process and ultimately better results for end investors. This is a point we come back to later.

Calibrating risk appropriately

The UK financial services sector is world leading which helps fuel the wider economy. To maintain this, it is vital that the sector remains competitive. Today, our members own a third of the FTSE and invest in thousands of unlisted and high growth companies, infrastructure projects, and of course buy UK government debt. In addition, we provide over 126,000 jobs and are responsible for 5.5% of the UK's total exports in services.

Even more fundamentally, having a world leading investment management sector in the UK makes it easier for British savers to access the very best products and expertise which helps empower them financially. A regulatory focus on growth, including ensuring that consumers have access to the products and services which will help them to save for their financial futures, is key to boosting this.

It is appropriate that the FCA's primary objectives to promote high standards of consumer protection and the integrity of the market remain a key focus. However fully implemented, the new secondary objective for competitiveness and growth supports the UK's world leading financial services industry to drive the broader economy. Striking a balance between protecting consumers and fostering growth requires careful consideration. Thus, it is essential to evaluate all changes, regardless of their perceived impact, through the lens of how they might affect competitiveness.

In part, this is due to an approach rooted in 'safetyism', which is hampering our collective risk appetite. Safetyism is the over-focus on eliminating risk without considering the wider unintended consequences. To enhance investment managers' ability to boost financial returns and allocate capital efficiently, we must tackle the challenge of defining appropriate risk. In recent years, government and regulatory narratives have often portrayed risk as something to be eliminated, which can discourage investment. This particularly impacts those unfamiliar with investing or who lack exposure to it in their social circles. Although well intentioned, this has resulted in many positive benefits for individuals and the wider economy being lost. While recent regulatory efforts have begun to acknowledge this, it's time to extend the move away from safetyism more widely.

Effective regulation entails designing a framework that reflects the market and manages risk appropriately. Regulation should support growth and investment, promote competition, work for consumers and enable innovation. This must recognise that differing levels of protection are appropriate in different markets: ordinary consumers need more support and safeguarding than the professional capital markets. We view applying the same standards to both as a serious risk to how attractive the UK is to international businesses.

Embracing innovation

The issue of risk links closely to innovation. We have repeatedly emphasised that the regulatory regime must both enable and stimulate innovation, embracing the unprecedented technological change ahead. We welcome the positive emerging alignment and increasing engagement between industry and regulators on this key area of the reform agenda, notably around fund tokenisation and the recent report on AI as part of the Asset Management Taskforce. The model of intense and targeted engagement in the form of regulatory 'sprints' is a subject we return to later.

We are also highly encouraged by the direction of travel in the emerging work on retail market disclosure and advice/guidance, where FCA recognition of the need for significant changes will likely transform the retail delivery landscape over time. In these two areas, we see a strong potential for the combination of a new approach to risk and the embrace of innovation offering the opportunity to transform customer delivery and engagement, without sacrificing core priorities in the area of consumer protection.

Part Two: Priority areas of focus and impact

This section highlights two main areas of reform that we regard as having the greatest impact and deserve further attention.

Evolution of the Value Process

As noted above, a key area of interaction and tension with the Consumer Duty is the COLL[4] Assessment of Value (AoV) regime for authorised investment funds. The AoV process has been in place for a number of years, following the AMMS[5], which introduced a significant set of governance and commercial requirements for the UK fund industry. Since the AoV rules came into force in 2019, the industry reports that AoV has had a notably positive effect on governance. As reported in the FCA's AoV Multi-Firm Review[6] last year, firms have been improving in a number of areas, particularly in their understanding of the rules and integrating the assessment into BAU. The IA has had significant engagement with the FCA throughout the course of this year around firms' AoV processes, and welcomes important clarifications made on its supervisory expectations on some key areas such as economies of scale, performance and overall governance. The IA continues to support its members to ensure that standards of good governance and robust decision-making feature in their AoV processes.

Three specific points require consideration in a new Consumer Duty world:

- Coherence through the value chain. Consumer Duty introduced new requirements related to value. Firms conducting COLL AoV for their authorised funds are not required to undertake a CD fair value assessment, compliance with COLL AoV is deemed to be sufficient to meet the price and value outcome of the Duty. However, there are key differences between the COLL AoV which is a backward-looking process and a Consumer Duty value assessment which is forward-looking.

  The COLL AoV requires Authorised Fund Managers, for each fund they manage, to consider whether costs paid by investors in the fund are justified in the context of the value delivered. The CD fair value assessment requires firms to consider whether a product is providing fair value to customers.

  As a result, reporting the outcome of a COLL AoV may therefore not necessarily align with the fair value process being considered by the distributor, who has new responsibilities under the Duty to obtain enough information to understand the outcome of the manufacturer's value assessment. In response, the industry has worked hard to develop a framework in the form of the European MiFID Template (EMT)[7] which has facilitated a coordinated and proportionate approach to data sharing through the value chain. Whilst we understand the EMT process and information sharing from manufacturers to distributors has been adopted by the market and is working well, the IA continues to remain vigilant. We make further comment on the information flow from distributors to manufacturers below.

- Evolution of COLL AoV public reporting. Last year, the IA conducted research on its members' implementation of the AoV, including on the costs versus benefits of the external reporting element which is a significant requirement. The findings reflected previous discussions with firms since the AoV process was implemented. Industry views are supportive of the governance process, but repeatedly report that it is a resource-intensive process that results in little to no engagement from consumers with the final report, raising questions about the cost and utility of the public reporting process. The current status quo is therefore unsatisfactory given the levels of investor

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[4] Collective Investment Schemes Sourcebook (COLL), FCA.
[5] Asset Management Market Study – Final Report, FCA, 2017.
[6] Authorised fund managers' assessments of their funds' value, FCA, 2021.
[7] European MiFID Template (EMT) Version 4.1, FinDatEx, 2023. The latest version can be accessed at FinDatEx.

readership. Importantly, there is no requirement to produce a public report under the Consumer Duty which again creates an unlevel playing field.

The IA and its members would welcome the opportunity to work together with the FCA to address this long-standing issue. As mentioned, AoV has become an important piece of the product governance process, but we are keen to explore different approaches to reporting, which could facilitate greater flexibility and less resource-intensive processes, where firms can have more discretion over form and content to produce simpler, more reader-friendly output. There is merit to having a simplified approach in the context of the Duty, while retaining a goal focusing on transparency and improved investor engagement. We invite further dialogue on this matter, including exploring the formation of a working group with manufacturers, distributors, the FCA and other relevant stakeholders.

- Potential rationalisation in due course. With the recent publication of CP24/16 (The Value for Money Framework)[8], we are potentially heading for three distinct but closely related UK regulatory regimes for assessing value across the retail investment and pensions markets: COLL AoV for investment funds, Consumer Duty Fair Value and DC pensions VfM. Depending on the final VfM rules we may have fairly prescriptive requirements for COLL AoV, very prescriptive requirements in the new RAG ratings under the VfM framework and for the Duty we have a slightly less prescriptive approach.

  The implementation of the COLL AoV regime for authorised investment funds five years ago, and the much more recent Consumer Duty Fair Value, provide valuable lessons which have potentially important ramifications for VfM in the DC pensions market. The COLL AoV process does not readily translate into consistent metrics or RAG ratings and current proposals to introduce RAG ratings in the context of pension scheme VfM should take account of this experience before potentially requiring comparisons and automatic actions stemming from a given period of assessment.

  The outcome of this can only be confusion for retail consumers, who may struggle to understand the significance of different processes. This goes very much to the different approaches arising from outcomes-focused versus more prescriptive rules. Looking forward, there is arguably a case for looking at how these three regimes could be made more consistent. However, the various sunk costs and established processes under COLL AoV mean that this may not be straightforward either. Future retail regulation should adopt as holistic a view as possible at the outset to proactively avoid these complications.

Client categorisation

The UK's client categorisation regime is a mixture of MiFID-derived requirements, with UK-specific rules layered on top. What began life as a relatively simple client categorisation regime, dividing clients into retail and professional clients, with an eligible counterparty status applying in limited services has been complicated by other regulation and the industry's approach.

Current approach

The MiFID-based client categorisation regime[9] (eligible counterparties aside) divides clients into retail and professional clients. The investment management industry, particularly the funds industry, develops and manages products or compartments of products for retail and institutional/wholesale clients. The definitions of retail and professional and retail and institutional do not map exactly to the MiFID retail/professional split and there are further, generally accepted categories used in product governance processes. In addition, a further breakdown of the categories includes retail clients being deemed sophisticated, high net worth or qualified in order to invest in some products and professional clients being deemed 'per se professional' or 'elective professional'.

[8] CP24/16: The Value for Money Framework, FCA, 2024.
[9] Conduct of Business Sourcebook (COBS 3), FCA.

To be classified as a sophisticated or high net worth client or as a per se or elective professional client, a client must meet a number of thresholds related to entity type, size or net worth, composition and experience. These criteria should be brought up to date to become more UK-centric and reflect changes in investing, e.g. the requirements around the number of trades to have been undertaken are excessive for clients investing in e.g. private markets. Our members would welcome more guidance around the different types of retail client, in particular which product types would meet the differing needs of different strands of retail client. Such refinement could go hand-in-hand with a rationalisation of the complex/non-complex product categorisation and suitability and appropriateness rules.

In addition, some requirements for professional, high net worth, qualified, or sophisticated clients, such as information to be provided to clients can be deemed excessive and inappropriate for clients of this type. In our response to the 2019 HM Treasury Call for Input and in subsequent engagement with the FCA, we highlighted that this was the case for investors in a Qualified Investor Scheme and we continue to advocate for a proportional approach to be taken for these client types.

<u>Broader Retail and Institutional split</u>

Moreover, we believe that this review presents us with a real opportunity to push for a clearer differentiation between retail market regulation and the wider institutional market.

While the UK asset management industry serves an extremely important retail market, its institutional client base both in the UK and overseas is of a much larger scale, accounting for 75-80% of total assets under management in recent years. There are examples of recent regulatory innovation, most importantly the Duty itself that applies only to retail clients and it is unclear how firms providing products and services to both types of client should make the distinction. This needs to be reflected better in the future regulatory architecture.

Although the distinction is not always clear in practice (for example, in the DC pensions market), asset managers who seek to provide services and products for institutional investors are increasingly required to comply with investor protection and disclosure requirements designed for retail investors. This unnecessarily increases the regulatory burden and costs that apply to firms seeking exclusively institutional business without an obvious benefit to consumers. There are a number of examples here that we wish to highlight:

- Requiring authorised funds that are only offered to institutional investors to produce and provide a Key Investor Information Document, which is of no value to institutional investors. This is due to institutional investors typically having a deeper relationship with their investment managers, along with greater access to individuals within firms, as well as detailed and often bespoke reporting in relation to their investments.
- Many international and institutional-focused businesses who do not have a UK retail business have been caught by the Duty given the breadth of application and scope. The most egregious example here concerns those firms who are providing investment management services to Defined Benefit (DB) pension schemes and are obligated to consider whether products and services intended exclusively for institutional or professional investors (in this case the scheme's trustees) fall into the scope of the Duty. In respect of the actions of service providers to scheme trustees, we do not see how this can materially influence the outcomes for end retail clients given DB scheme members bear no investment risk and have a financial backstop (in the form of the corporate sponsor and ultimately, the PPF) and that their pensions are guaranteed. Indeed, given the regulatory framework that DB schemes operate under in relation to their funding arrangements, some of the products they invest in have been designed specifically with their funding and investment needs in mind and would never be distributed to retail clients. For example, Liability Driven Investment strategies, which make significant use of derivatives and leverage. In light of the fact that these are professional clients, effectively forcing firms to undertake a scoping exercise to confirm the Duty does not apply is nonsensical. It would have been beneficial for the FCA to act more decisively in

this area, which should be straightforward to remedy. Instead, the FCA has refused to provide a blanket exemption, while not specifying how the Duty could apply in this instance.

- The classification of local authority pension funds (LGPS) as retail clients under MIFID II necessitated the creation of an LGPS-specific opt-up test to address the issue of LGPS funds being unable to access professional-only products. Although this was developed by the FCA with positive intentions to address the inflexibility of the MiFID II requirements, it has added a further layer to the rules and also made marketing communications and conversations with potential clients ahead of an opt-up process being completed more challenging. While the industry and LGPS has made the opt-up process work, there are differing views over how helpful the rules really are.

Decreasing the regulatory burden on these types of firms which operate in a non-retail environment will create a more proportionate and tailored regulatory regime, that bolsters the UK's competitiveness as a global hub for asset management. A full review of requirements is required in order to explore the scope for a different demarcation between the requirements applying to products and services intended for distribution to retail markets, and those designed exclusively for institutional and professional markets.

<u>Impact of overlapping regulatory regimes in the UK pensions market</u>

We wish to highlight two areas where the UK's dual – and overlapping – regulatory regime for pensions has a complicating effect on firms serving the UK pensions market.

In relation to the Consumer Duty and its application to the DC pensions market, investment managers are captured by the Duty, but their trust-based pension scheme clients – regulated by the TPR – are not. This is problematic for investment managers who do not have any direct access to underlying members or to the data it needs to do its CD related assessments and monitoring. Firms may struggle to get their pension scheme clients to assist with CD related data and insights so there is a tension between what the Duty requires of firms from an evidence / data / monitoring perspective versus what is possible / practical given the commercial reality and the different regulatory regimes that apply. This is an issue that the FCA and TPR should work together to address.

Secondly, there are concerns regarding the overlap between the FCA and TPR regulatory regimes and the impact on OPS (Occupational Pension Scheme) firms – the in-house investment management firms of occupational pension schemes. The (sole) pension scheme clients of these firms are subject to extensive pensions legislation and oversight by TPR, yet this has not always been recognised in the development of overlapping FCA regulation, creating a risk of regulatory duplication and its associated costs. For example, the FCA's initial proposals on TCFD reporting in 2021 overlapped with DWP requirements on OPS firms' TPR-regulated clients, which would have resulted in burdensome and duplicative reporting. While the FCA did subsequently amend the proposals to take account of feedback received, a more tailored approach to the initial policy development would have been helpful.

Part Three: Broader Principles for reviewing the Handbook

A single, streamlined rulebook benefits all stakeholders. It simplifies operations for practitioners, reduces duplication and complexity for supervisors, and potentially minimises errors and harm, thereby improving client outcomes. A thorough, line-by-line review of the Handbook is necessary to resolve the inconsistencies and complexities within the FCA's current rules and requirements. This will involve embarking on a more extensive and detailed project, in collaboration with industry and other relevant stakeholders. In this part of our response, we present a number of key principles to guide a review, along with some examples for illustration.

1. Rationalisation: The Handbook and the wider message

A core concern raised by firms is the broad range of FCA expectations beyond the Handbook, in the form of guidance, speeches, thematic and multi-firm reviews and Dear CEO letters. There has been increasing proliferation of guidance and commentary which sits outside of the Handbook, where it is sometimes challenging for industry to access in one place a clear statement of regulatory expectations. Many new firms or market entrants interpret the rules as they are without the advantage of historical context. This has led to complexity and confusion, making it difficult to distinguish between current and outdated rules. The FCA should communicate very clearly to the market if it anticipates that its expectations have now changed on a particular policy area or rule.

More broadly, there is the sense that it is not just the rules that can impact the cost of compliance, but how those rules are interpreted by supervisors. Effective supervision, especially of an outcomes-based regulatory framework (recognising that regulatory policy is de facto made and imposed through supervision) requires FCA teams with a strong understanding of the sector they are overseeing who are able to make judgements on what is or is not reasonable. IA members have reported inconsistent supervisory approaches. It also involves considering what supervisors might regard as good practices, which may not align precisely with the strict interpretation of the rule.

This is especially the case with Consumer Duty, which has seen numerous FCA communications aimed at sharing insight and promoting good practice. While we appreciate the FCA's efforts to engage proactively and constructively with the industry in line with its "iterative approach" to the Duty, there is a risk more generally that firms may miss important information that is material to their compliance efforts. While firms have an established regulatory change process, tracking and digesting the multitude of FCA communications across sectors is challenging, adding to the compliance burden. This is heightened by the increasing use of speeches which are aimed at raising the standards of awareness. There is concern, potentially from an enforcement angle, for some firms, where the FCA may take action against a firm for not complying with expectations communicated separately to the Handbook.

Beyond the Consumer Duty, we encourage the FCA to consider whether such communications could be more efficiently centralised, consolidated or integrated into the Handbook that effectively serves as a 'source of truth', for example by including links to relevant sources in the Handbook as appropriate and making clear what Guidance is still live and what has been retired.

2. Modernising the Handbook to reflect the current nature of the industry

Having a regulatory framework that keeps pace with an evolving investment management industry is essential for ensuring that the UK remains competitive. We note that certain elements of the Handbook are very much a product of the time at which they were created and no longer reflect the present environment in which firms operate.

<u>COLL and CASS</u>

COLL, which replaced the previous Collective Investment Schemes Sourcebook (CIS) in the mid-2000s, took a number of the CIS rules which reflected the funds industry at an even earlier time. Unitholders on a fund's register were largely direct holders, who invested using a paper application form accompanied by a cheque. Unitholder instructions in many cases cannot be acted on without a wet signature. Funds are now largely held through an intermediated relationship, with little to no direct contact between the fund administrator and end investor. Fund dealing is almost exclusively through electronic and often straight-through processes and payment can be instantaneous.

The current UK fund dealing model, where the AFM acts as agent between the investor and the fund entity is unique in the global industry and produces operational complexity for firms with an international presence. Our Direct2Fund proposals[10], to enable parties to transact without the AFM's involvement, would modernise and simplify this part of the infrastructure and enable the UK industry to align itself to international norms. We have submitted proposals to change COLL and CASS[11] to facilitate this and look forward to the results of the FCA's review, as announced in the 2023 speech concluding the review of the regime for asset management[12].

The change management process is another area that could be streamlined and modernised. The current process is manual and can be inefficient, with PDF application forms and information sent between parties by email. An intuitive system, with simultaneous access available to various parties, including the fund lawyers and depositary has been under discussion for some time. COLL also requires updates to reflect the different environment in which funds now operate. For example, it is unusual for intermediaries, such as platforms to attend EGMs and vote on fundamental changes, making it difficult for a firm to effect such a change, usually to the detriment of investors. It would be beneficial to align with other jurisdictions, where EGMs are no longer required for any changes.

Furthermore, COLL should enable managers to act to improve outcomes for those legacy unitholders that are a direct unitholder and are not engaged or cannot be contacted. Often these unitholders will be in trail commission-bearing arrangements and invested in dwindling share classes for whom economies of scale are fast decreasing. A move to a larger, clean share class can often result in a better outcome for unitholders, but managers are unable to do this without express consent of the unitholder. Where a manager cannot ascertain that a trail-bearing share class is still the correct one for these unitholders, it should have the ability to move them to a clean share class. The IA has engaged with the FCA on this subject for a number of years and we would be pleased to reach a conclusion.

On a similar point relating to uncontactable investors, the expansion of the Dormant Assets Scheme for invested assets is unlikely to proceed as hoped. The rules recently published[13], whilst successfully enabling firms with client money balances to participate effectively, include requirements for firms to maintain on an ongoing basis a record of investor-level entitlements to fund events which can be achieved in a far easier way than outlined. The complexity that this brings will inevitably have the effect of making the participation of firms commercially unviable for this element of the scheme.

The CASS Sourcebook has undergone a number of major updates in the last decade and remains a major source of investor protection, as client assets treated correctly under CASS will never be at risk in the event of an investment firm's failure. We agree that the basic premise of protection of client money and assets must be preserved, but counter that the CASS rules remain outdated and the Sourcebook is unwieldy. A complete review of the Sourcebook, to reflect updated and changing payment systems and settlement periods is required. The CASS audit regime is another example of a significant cost to firms, disproportionately so for smaller firms for negligible benefit to consumers.

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[10] Direct2Fund: Proposals for an optional alternative to the principal fund dealing model, The Investment Association, 2022.

[11] Client Assets Sourcebook (CASS), FCA.

[12] Ashley Alder: *Updating and improving the UK regime for asset management: our priorities*, 2023.

[13] PS24/10: Expansion of the Dormant Assets Scheme – second phase, FCA, 2024.

3. Simplifying the Handbook

As noted in DP23/2, one effect of the duplication of rules is that the current rule framework often leads to identical or broadly similar activities being regulated to a slightly different standard. Different rules apply depending on whether a firm is managing a segregated portfolio for an individual client, an alternative investment fund, or a UCITS fund. Sometimes the differences in the rules are mainly technical detail but seeking to achieve the same outcomes. As noted in our response to DP23/2, we believe that the creation of a common framework makes sense and simplification should be a clear goal. We set out below a number of areas where simplification, including by addressing overlapping regimes, would be beneficial.

Client categorisation

A key area that requires simplification is the UK's client categorisation regime, which is a mixture of MiFID-derived requirements, with UK-specific rules layered on top. These are points we have highlighted in Part Two above as a priority for change.

Financial promotions

The financial promotions rules, contained in COBS 4[14] cover a variety of products and services. The rules can be confusing as regards definitions with respect to the types of products covered and the types of client to whom they can be promoted. There is also an overlap with the consumer understanding requirements in PRIN 2A.5 and the rules set out in COBS 4.2 and COBS 4.5 in relation to communications to retail clients. A harmonisation of the various regimes, tied in with a review of what information needs to be provided to retail and professional clients and how that information should be presented will go a long way to simplifying the financial promotions regulatory process for firms.

Consumer Duty, Consumer Understanding and the Future of Disclosure

The industry clearly recognises its continued responsibilities in driving up standards of delivery, particularly in areas which are most challenging, such as customer understanding. It is well established that few consumers read pre-contractual disclosures, so the future of disclosure presents a valuable opportunity to depart from prescriptive disclosures like PRIIPs and develop an improved framework which leverages the flexibility afforded by the outcomes-based principles of Consumer Duty.

We set out our vision for the Future Disclosure Framework in our response to DP22/6[15] and look forward to responding to the forthcoming CCI Consultation Paper in due course. Getting disclosure right is essential for enabling consumer understanding and will play an important role in empowering consumers to make informed decisions and pursue their financial goals. Our emphasis in Part One on the need to move away from safetyism is also relevant here. A further dimension to this is the need to address how risk is presented. We have two central proposals to improve the way risk is communicated to consumers, based on recalibrating risk warnings and also adopting a consistent approach across products.

First, risk disclosures should be reformed to inform and empower consumers, rather than simply warn them. This aligns with Consumer Duty obligations and ensures that risk warnings are balanced and appropriate for the target market. By presenting both the risks and potential rewards, disclosures can foster a deeper understanding of the investment landscape. This approach will encourage more confident and engaged investors who are better equipped to make informed decisions. The IA supports the FCA's ongoing reforms to the retail disclosure regime and advocates for a comprehensive approach that emphasises this balanced perspective.

Risk warnings should be communicated in ways that do not inadvertently discourage certain groups. September 2024 research by the IA shows that only 14% of women hold a stocks and shares ISA, compared to 26% of men. Findings by our members show that traditional risk warnings ('Capital at Risk') often discourage women more than men. Members with investment platforms have observed these trends when

[14] Conduct of Business Sourcebook (COBS 4), FCA.
[15] Response to DP22/6: Future Disclosure Framework, The Investment Association, 2023.

analysing the consumer journey and where customers drop out of it. However, when risk warnings are framed differently, such as stating, "Investing can over the long term outperform cash, however, investments can go up and down and you may lose money as well," customers, especially women, felt more engaged. Providing information on investment horizons further increased customer understanding of the balance between risk and reward.

Second, consistent risk information should be provided across all financial products, including cash products and cryptocurrencies, which should be subject to risk warnings similar to investment wrappers, accounts, and other products. Currently, many consumers are unaware of the risks associated with holding cash long-term, particularly the erosion of value due to inflation. Just as with other investments, consumers should be informed that while cash may seem safe, it carries its own set of risks over time.

As the FCA designs the future disclosure regime, we ask that it considers the impact on competition and compliance costs, particularly with respect to compatibility between the UK and Europe. As the UK forges its path post-Brexit, the divergence from EU regulations, such as PRIIPs and MiFID, could create challenges for firms operating across borders. A separate retail disclosure regime for the UK will make operating here more expensive for firms. The UK's framework must be robust enough, and beneficial enough to consumers, to stand on its own while still being compatible with global practices, allowing UK firms to compete effectively in international markets. This is a point we emphasise later.

Consumer Duty and Product Governance (PROD)

Since the implementation of MiFID II, firms have complied with the PROD Sourcebook[16] for both MiFID business and for non-MiFID business, notably authorised investment funds. Our members therefore welcomed the 'equivalence' or substituted compliance confirmation in PS22/9 (A new Consumer Duty)[17] that the products and services outcome under the Duty does not apply to any firm subject to PROD 3 and that firms currently following PROD 3 as guidance may choose whether to follow the rules in PROD or those under the products and services outcome. However, during the course of implementation of the Consumer Duty, many firms choosing to continue with PROD 3 felt that investors would achieve a better outcome by firms incorporating elements of the products and services regime into their product governance processes. Consequently, many product manufacturers have reviewed both sets of requirements in detail, leading them to adopt a 'PROD+' process.

Some members believe that it would therefore be beneficial to combine the two regimes into a single unified framework, based on the elements of each regime that the industry agrees leads to the best outcomes for investors. This would provide consistency, with all firms following one regime, but would require considerable cost and resource for firms to implement, at negligible anticipated additional benefit for consumers.
It has also been suggested by other members that combining the regimes would impose a wider set of rules on firms, whereas any Consumer Duty 'uplifts' (in relation to the products and services outcome) are currently deemed voluntary.

Outcomes for consumers and TCF/client's best interests rule

The Consumer Duty has meant that firms have largely discontinued their reporting under the Treating Customers Fairly (TCF) rule. Alongside this, the rule requiring firms to act in clients' best interests has also been superseded by the higher general standards set by the Duty for retail clients, particularly Principle 12, which requires firms act to deliver good outcomes for retail customers. This creates ambiguity regarding the continued applicability of these rules to retail clients and whether they should remain for professional clients.

[16] Product Intervention and Product Governance Sourcebook (PROD), FCA.
[17] PS22/9: A new Consumer Duty, FCA, 2022. 2A.3.24 R/2A.3.29 G

Part Four: Response to Call for Input Questions

We have not attempted to answer every question presented in the Call for Input, although we address several of the broader themes discussed collectively within. We consider that certain questions necessitate further analysis and collaboration.

As noted in Parts Two and Three of our response, we have identified key areas that the industry considers will deliver positive impacts on innovation and the international competitiveness of the UK. Firms remain cautious about seeking change for change's sake, recognising that each change incurs associated costs. Potential downstream impacts and unintended consequences must be carefully considered in any review. We broadly agree that simplification can help support objectives that facilitate high consumer protection whilst recognising that outcomes-focused regulation can also promote growth and flexibility. However, we would like to see this balanced, with a reduced regulatory burden to promote the competitiveness of the UK.

Below, we point out several important factors to consider as we approach this review.

Outcomes versus prescriptive rules

Outcomes-based regulation aims to ensure that regulatory actions lead to the desired results for consumers and the market. Its intention is to provide flexibility for a firm to determine the best way to achieve the desired outcomes, allowing for innovation, adaption to economic conditions, without constant need to rewrite rules. It can be applied to different types of firms. However, it also comes with a level of ambiguity and potentially higher compliance costs in some situations. Detailed rules can offer more certainty and be beneficial for consistency and comparability.

We do not see this as a simple choice between outcomes-based and prescriptive regulation. The picture is more complex and nuanced, with no single right answer:

- Views on whether outcomes-based or prescriptive rules are more suitable will also sometimes vary based on a firm's size, the nature of its products and services, and its international presence, especially within the EU. Some firms may prefer a balance of the two. Other firms are unlikely to support a move to wholly outcomes-based regulation.
- Different approaches may be better suited to different circumstances, depending on the desired regulatory outcomes. This will then serve as the starting point for determining the best format to securing a given regulatory objective. Prescriptive rules may become necessary in scenarios where the risk of harm is higher or when the nature of the regulatory intervention would benefit from a proportionate level of prescription.
- Even outcomes-based requirements themselves can vary; they could take the form of detailed outcomes which offer firms discretion in how to achieve them or consist of broader outcomes which are accompanied by specific guidance on how they should look in practice. We envisage a sliding scale, depending on the rule. For example, transaction reporting and costs and charges information may require the need for more prescription on one end, whereas value assessments may lie further down the scale with less prescription if there are many ways of achieving the same outcome.

It is worth noting that outcomes-based regulation is still very much in its infancy in the UK. At this stage, we do not necessarily have all the evidence and data available to discuss thoroughly the benefits of using more outcomes-focused frameworks. While the final Consumer Duty implementation dates have passed, it is still being fully embedded and there are elements of the Duty which still remain unclear (as highlighted below).

Arguably, outcomes-based regulation has proven to be more difficult than initially assumed. High-level rules do not always translate to simplicity or lower cost, as evidenced by the complexities encountered during the Duty's implementation. The shift to outcomes-based regulation is not a zero-sum game; and will inevitably entail consideration of how these changes will need to be communicated to investors and the costs of doing so. In some circumstances, firms may end up retaining existing practices required by earlier prescriptive rules. In contrast, newer firms and market entrants may design their procedures without reference to these requirements, potentially leading to a divergence in approaches between established and newer firms. Therefore, care should be taken not to remove too much prescription too quickly, in recognition that newer firms will not have the knowledge of earlier prescriptive rules on which to base their compliance efforts.

Outcomes-based regulation is also likely to result in a requirement for more non-Handbook/soft guidance. However, firms desire real regulatory and legal certainty, especially in an enforcement context, in terms of what the regulator expects. This leads to a real risk that regulation is implemented in a much less predictable way, with supervisors relying on case law, such as the Financial Ombudsman Service (FOS) and information imparted in speeches and Dear CEO letters. Firms will wish for consistency of treatment and as much clarity as possible on how FOS would view matters in the absence of prescribed rules. The FCA therefore needs to discuss areas of potential changes with FOS to understand whether there is any potential that removing prescriptive rules may impact the clarity and consistency of FOS rulings.

Finally, while outcomes-based rules can lead to higher standards in consumer protection, with accountability and transparency, it will require a different type of supervision. This requires FCA teams to have a deep sector knowledge, though it remains too early to assess how the FCA will supervise and enforce the Duty in line with its ambition to become a more agile regulator and intervene in real time where it sees actual or potential consumer harm.

Regulatory process

As the FCA and industry consider a different and modern approach to regulation, this review presents us with an opportunity to take a more dynamic approach to regulatory creation and execution. The industry is experiencing shorter formal consultation cycles and tight deadlines to deliver on regulatory change initiatives. While timing of consultation responses is important, there are broader points here on finding other ways to engage with industry early and interactively. We encourage the FCA to be open, direct and collaborative with industry and practitioners on its regulatory intention before formal consultation processes begin. As we emphasise below, some of the challenges we have faced with Consumer Duty stem from it being a cross cutting regulatory initiative. We see scope for a different policy process that accommodates sector-specific structures, rather than broad, one-size-fits-all regulation. We look forward to working with the FCA to find ways to engage early and constructively (e.g. roundtables, sprints, bilateral meetings), so firms have sufficient capability to input and plan accordingly.

Ambiguity and interpretation of the Consumer Duty

The main challenges in implementing and understanding the Duty stem both from its overlap with existing regulations and the ambiguity and lack of clarity in some of its requirements. We appreciate the need to ensure that the Duty can be applied to all sectors of the financial services industry, but this has led to the provisions being vague and, in some cases, too open to interpretation, which can lead to inconsistency and disproportionate complexity in its application.

Two examples under the Duty are particularly relevant here:

1. **Vulnerable customers**: The important responsibility of supporting vulnerable customers has proved challenging to operationalise given the highly intermediated distribution model of the investment fund industry. Manufacturers and distributors have had significant discussions about how to discharge the responsibility in a way that is effective and identifies genuine areas of priority. This is a clear example of where the Duty is framed so broadly that it potentially creates disproportionate requirements.

   Fund manufacturers can – and do – assess products for generic characteristics, such as low capacity for loss (and transmit this information in the EMT). It is not realistic to consider multiple individual characteristics such as mental illness or temporary financial hardship. Building on dialogue with the FCA and other stakeholders to seek clarity on these points, we will continue to develop an industry response in line with FCA expectations.

2. **The Distributor Feedback Loop**: Information sharing under the Duty has presented a number of challenges around allocation of responsibilities throughout the retail distribution chain and what is deemed actionable and proportionate data. The requirement for distributors to provide information to assist manufacturers in their product review processes under the Duty is one such example. While such obligations existed under previous regulations, the Duty has reinforced expectations around data sharing. The Joint Trade Association Group have developed an industry framework in the form of the Distributor Feedback Template (DFT)[18] to support the industry and market participants, with the data provision to help meet the specific requirements. While the industry continues to monitor the adoption of the framework and assess how market practice evolves, it has also led to calls from industry to provide greater clarity on regulatory expectations, which would help to minimise costs involved and maximise the utility of the information shared.

Sector-specific guidance

If the industry is to see a shift towards principles-based regulation, this may necessitate in future the creation of supplementary sector-specific guidance to provide practical support. The industry would have benefited from clear guidance on applying the Duty to investment management and its complex intermediated distribution chain, specifying which aspects of the Duty apply to manufacturers and which are more relevant for distributors who are closer to the end investor. Another example we would point to is determining the scope and application of the Duty where we have seen a number of challenges, including interpretating the meaning of 'material influence' applied to sector-specific scenarios (we refer to our earlier point on DB pension schemes).

International alignment

The UK investment management industry is a leading centre of excellence in global institutional and retail markets, providing portfolio and fund management expertise to millions of customers in the UK, Europe and globally. This gives the industry a distinctive perspective on meeting customer needs and the ability successfully to operate across multiple regulatory jurisdictions.

For the UK, the post-Brexit adaptation to a new relationship with the EU and with multiple global and regional partners has added an additional layer of complexity to the operating environment for investment managers. There will be varying views presented depending on whether firms are operating an international business or are more domestically focused. A full-scale review of the Handbook (and the SRF) provides an opportunity to move from prescriptive EU rules, while other firms with a European business may favour alignment. Therefore, firms may benefit from the flexibility afforded by outcomes-based rules when complying with rules across different jurisdictions. Conversely, the removal of prescriptive rules can create uncertainty in terms of equivalence which can make it harder to align with international rules.

To enable our industry to thrive in a global market, we need to ensure there is regulatory alignment or a sufficient degree of interoperability between UK and EU regimes to facilitate cross-border business and support domestic and international competitiveness. We note the difficult and sensitive challenge in getting the balance right and recognise that this also extends beyond interoperability to include considerations around the timing of regulation across multiple jurisdictions and the practical implications arising from inevitable differences between different regimes.

[18] Distributor Feedback Template (DFT) Version 1.0, the Joint Trade Associations Group, 2023.

Part Five: Next steps and prioritisation

The IA supports the FCA's commitment to revising its Handbook to make it simpler and less onerous for firms, whilst ensuring high standards of customer delivery, fostering growth and innovation. This cannot be achieved in a single instance, and the industry must be given the capacity to manage this undertaking. We reiterate the level of resource and practical consideration required for such an exercise. A wholesale review of the Handbook is imperative over the long term, with a prioritisation strategy as the next step is essential to facilitate progress. Given the demanding regulatory agenda, the industry needs ample time for thorough consideration and analysis.

We recognise the complexity of this challenge, given its cross-sector nature and the fact that significant parts of the Handbook derive from EU law. As highlighted in the CfI, several initiatives and ongoing efforts linked to the Smarter Regulatory Framework have already prompted a reconsideration of the regulatory framework's structure. However, a full review is essential to ensure that the UK remains competitive and enables the industry to innovate in the best interests of consumers.

Deliverables:

- The IA advocates for the creation of an Investment Management Regulatory Forum/working group(s) to promote dialogue between industry and regulators, fostering a more collaborative approach to policy development and prioritisation for the benefit of consumers. This would enable the industry to engage in a more effective and sequenced manner.
- We also identify an opportunity for increased emphasis on targeted areas through regulatory sprints and the testing of any potential regulatory interventions.

We look forward to working with the FCA and other relevant stakeholders to develop this proposal further, with the goal of creating a regulatory framework that maintains the UK investment management industry's global excellence and promotes good outcomes for its consumers.