

UK DEVELOPMENTS: CONSUMER DUTY AND OTHER CURRENT REGULATORY TOPICS AFFECTING SECURITISED ASSETS

Developments in UK financial regulation over the last 18 months have substantially increased the attention which originators, other participants and investors in securitisations of UK retail assets need to give to regulatory risk.

UK context

The regulation of the conduct of financial firms in the UK is undertaken by the Financial Conduct Authority (“FCA”), which has statutory objectives of protecting consumers while ensuring that financial markets work well. Disputes between consumers and financial services firms relating to many regulated products are subject to the jurisdiction of an independent and free Financial Ombudsman Service (“FOS”). The FOS determines hundreds of thousands of cases referred to it by consumers or their representatives every year, and in doing so it has regard not only to the law and FCA rules, but it also applies a broader “fair and reasonable” test.

This results in consumer-friendly regulations and consumer-friendly dispute resolution. This context needs to be borne in mind when assessing the impact of recent developments in UK regulation.

Consumer Duty

The most significant of the recent UK regulatory developments is the introduction of the FCA Consumer Duty¹. This new Consumer Duty came into force on 1 July 2023 for new and existing products that are open to sale or renewal, and it comes into force for closed book products on 1 July 2024.

The Consumer Duty has introduced a new Consumer Principle, requiring firms authorised by the FCA to act to deliver good outcomes for retail customers. This

basic Principle is supported by cross-cutting rules requiring authorised firms to act in good faith, avoid causing foreseeable harm and enable and support retail customers to pursue their financial objectives.

In addition to these cross-cutting rules about how firms should act, there are rules relating to four outcomes the FCA wishes to see:

- **Products and services:** consumers receive products and services that have been designed to meet their needs;
- **Price and value:** consumers pay a price that represents fair value;
- **Consumer understanding:** consumers are equipped with the right information to make effective, timely and properly informed decisions about their products and services; and
- **Consumer support:** consumers receive good customer service.

The Consumer Duty is supported by guidance issued by the FCA² and a number of sector-specific communications.

The FCA has been clear that the Consumer Duty applies to all authorised firms in the distribution chain that can influence material aspects of the design, target market or performance of a retail financial services product or service. The FCA has noted that although it will be possible in certain circumstances for books of products to be sold to unregulated third parties, general consumer law will apply to the behaviour of the buyer. Securitisation SPVs (special purpose vehicles) are generally not required to be authorised by the FCA, but in addition to the originator of securitised assets, a

¹ *A new Consumer Duty*, FCA Policy Statement PS22/9, July 2022. Available at: <https://www.fca.org.uk/publication/policy/ps22-9.pdf>

² *Finalised Guidance*, FCA, FG22/5, July 2022. Available at: <https://www.fca.org.uk/publication/finalised-guidance/fg22-5.pdf>

number of other participants, including servicers, may be subject to authorisation and thus subject to the Consumer Duty as a result of their ability to influence the performance of the product.

Mortgage charter and borrowers in financial difficulty

Shortly before the coming into force of the Consumer Duty on 1 July 2023, the Government and the FCA announced that the UK's major mortgage lenders had agreed to a Mortgage Charter³ covering the support that customers can expect from their mortgage lender, including support to switch to another deal at the end of a fixed rate deal, tailored support for customers in difficulty including considering payment deferrals or a period of paying only interest, and - as a general rule - no repossessions in less than a year from a missed payment. The announcement noted that the Consumer Duty would support this initiative.

In April 2024, the FCA further announced changes to its rulebook to strengthen protections for mortgage, overdraft and consumer credit customers in financial difficulty⁴. These rules, which embed guidance published during the Covid-19 pandemic, will come into force in November 2024. They broaden a number of the requirements of the Mortgage Charter to unsecured debt, including the requirement that consumer credit firms consider a range of forbearance options when borrowers get into financial difficulty.

Motor finance

Following FOS decisions in two cases involving motor finance, the FCA announced in January 2024 that it was reviewing historical motor finance commission arrangements and sales⁵. In summary, the FOS found that under discretionary commission arrangements ("DCAs") motor dealers acting as credit brokers were incentivised to increase the interest rates payable by car buyers, and these incentives and the levels of commission earned by the brokers were not fairly disclosed to the customers. The FOS decided that interest charged in excess of the minimum rate which the broker was authorised to offer to the customers should be refunded to the customers, together with interest at 8% per annum.

DCAs have been banned since 2021 but the value of historic motor finance loans which are potentially in

scope for remediation is significant; the FCA is looking as far back as 2007 although, it appears, not earlier. It is not clear what the FCA will decide, and it seems likely (in the light of continuing litigation and other issues) that it will take a considerable time to reach a final conclusion. However, there is potential for a significant redress scheme to be imposed on motor finance lenders which operated DCAs with credit brokers.

That said, Fitch Ratings has said that it does not expect the FCA's investigation to have a rating impact on UK Auto ABS transactions, given the financial strength of the sponsors and the likelihood that many of the loans now in these structures will have been originated after the ban on DCAs was introduced in 2021⁶.

Implications for securitisations of UK retail assets

The Consumer Duty, together with these other recent regulatory developments, underline the importance of conducting appropriate due diligence and ensuring that securitisations of UK retail assets are robustly structured and documented.

Due diligence will focus on:

- questions relating to the processes of both the originator and any third-party servicers for compliance with FCA obligations, as now expanded by the Consumer Duty, Mortgage Charter and rules for treating borrowers in financial difficulty, including processes for responding to changes in the customer's circumstances;
- the risk that the product is or will become subject to FCA investigation or redress as a result of any of the developments outlined above, leading to a risk of set-off if the originator defaults in payment of any compensation;
- the adequacy of record-keeping at the time of origination; and

³ See <https://www.gov.uk/government/publications/mortgage-charter/mortgage-charter>

⁴ Strengthening protections for borrowers in financial difficulty: Consumer credit and mortgages, FCA Policy Statement PS24/2, April 2024. Available at: <https://www.fca.org.uk/publication/policy/ps24-2.pdf>

⁵ FCA to undertake work in the motor finance market", FCA, 11 January 2024. Available at:

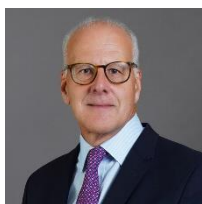
<https://www.fca.org.uk/news/statements/fca-undertake-work-motor-finance-market>

⁶ Pre-2021 Commission Probe in Unlikely to Affect UK Auto ABS Ratings", Fitch Ratings, 20 February 2024. Available at: <https://www.fitchratings.com/research/corporate-finance/pre-2021-commission-probe-is-unlikely-to-affect-uk-auto-abs-ratings-20-02-2024>

- the flows of information and record-keeping required to comply and demonstrate compliance on a continuing basis.

Structuring and documentation issues will focus both on the terms of contractual protections provided by the originator and the adequacy of the resources of the originator and any servicer to comply with those terms. In addition, other FCA authorised participants in the securitisation will consider and seek to address the risk that they are also caught by the Consumer Duty.

CONTACT



CHARLES RANDELL
SENIOR CONSULTANT
T: +44 (0)20 7090 3116
E: charles.randell@slaughterandmay.com

London

T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels

T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong

T +852 2521 0551
F +852 2845 2125

Beijing

T +86 10 5965 0600
F +86 10 5965 0650

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