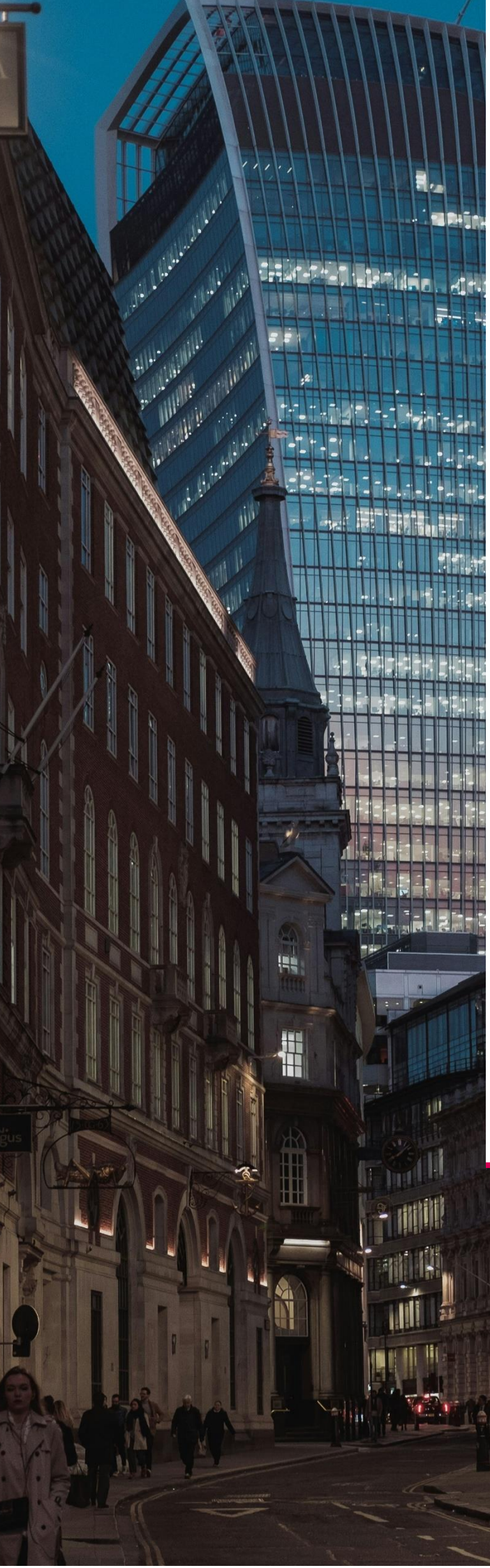


Wealth Management Annual Review 2024

dwfgroup.com

Editor's Note

Robbie Constance

Partner, Head of Wealth Management Regulatory

M +44 7545 100 514

E Robbie.Constance@dwf.law

Happy New Year and welcome to DWF's fifth Wealth Management Annual Review.

2024 was even more interesting than the prior year, with all its focus on finalising Consumer Duty implementation. The second half was dominated by topsy-turvy political and legal developments interplaying with the regulatory agenda to create evermore uncertainty, intrigue and risk.

Political dimensions

The new Labour government's 'growth' agenda was sold to the City in the Mansion House speech[1]. There was excited talk about megafunds and productive finance but the FCA's retirement income advice review and ongoing concerns about risks of illiquidity (for example with the Woodford saga) suggest retail investors may not be an easy source of growth capital. (Such is the talk about personal pensions in wealth management town that we've got a whole 'pull out section' on Pensions.)

The FCA's reaction was instant, with well-timed publications the morning after the Chancellor's speech the night before. There was an apparent change of direction and tone, with announcements about:

- Listing Rules / capital markets reform – and the Private Intermittent Securities and Capital Exchange System (PISCES) consultation on a new platform to allow private companies to trade their securities;
- The Advice Guidance Boundary Review (again); and
- Modernising the redress system – a FCA and FOS joint redress framework review.

Alongside these reforms, we have a post-Consumer Duty review of the Handbook to streamline and simplify it.

1 https://www.gov.uk/government/speeches/mansion-house-2024-speech

Just as we were wondering what liberalisation, greater risk tolerance and growth might look like in wealth management, the APPG on Investment Fraud & Fairer Financial Services issued a damning report[2] heading in the opposite direction: more consumer-protection; more FCA Enforcement action and more scam prevention. (Nikhil Rathi has started 2025 by throwing the questions about risk tolerance back to Government and Parliament[3]).

See below what Aaron says about a noticeable shift by the FCA towards data-driven, 'supervisory intervention' instead of Enforcement. The FCA's half-baked 'name and shame' proposals - to make an impact with earlier transparency about Enforcement investigations - were received so badly that the FCA had to consult again in November[4]. With only 10-12 investigations into regulated firms planned per year, and the implication those few are the worst offenders, the 'innocent until proven guilty' argument only strengthens. Whatever the outcome, the FCA's intention is clear and the proposals contain (at least) an implicit acknowledgement that Enforcement is too slow and blunt a tool.

Can the two apparently contradictory forces of growth and consumer protection be reconciled? Could the FCA de-regulate 'good firms' while focusing more on the 'bad actors' on the perimeter, online and overseas? This dynamic will be a key area of intrigue throughout the coming year and beyond.

The role of law

I've long bemoaned the 'lack of law' in (retail) financial services. (I was briefly involved in another APPG on Fair Business Banking which garnered support from Nicky Morgan when chair of the TSC for a 'Financial Services Tribunal' to fill the gap between the FOS and the Courts and to bring 'proper law' and more legal certainty to UK financial services).

As we reported last year (under the optimistic heading "Enforcement – the law still matters"), the Upper Tribunal had taken some bold decisions against the FCA in recent years which gave us practitioners hope, however hard it is to get all the way to the Tribunal. Too few cases are heard in the Courts, applying legal principles and tests, but here was (limited) proof there is still access to proper law and justice.

Then along came the Court of Appeal in the motor finance commission case; imposing a quasi-fiduciary duty on motor finance intermediaries to obtain informed consent to keep commissions. The FCA was put in a spin, asking the Supreme Court to expedite consideration of the more damaging implications. Most recently, Rachel Reeves steered the Treasury into the action. As it stands, firms that were complying with FCA consumer credit rules since 2014 could be liable for millions in redress. (Simon has written a detailed analysis on the possible spill-over into retail investment markets and concludes, reassuringly, that RDR compliance should protect adviser firms but there may be some undisclosed or un-agreed 'commissions' that are exposed).

And contrary to its reassuring words about the redress framework review, the FCA persuaded the Court of Appeal in *Bluecrest* to uphold its power simply to impose a Requirement on a firm to pay redress to investors. The firm had argued successfully in the Upper Tribunal that the FCA couldn't do that by way of a mere Requirement under s55 FSMA but needed to establish liabilities in accordance with the relevant rules, such as s404 on redress schemes. But the Court sided with the FCA, empowering it to do as it pleases with Requirements so long as they are aligned with its statutory objectives (in this instance, consumer protection).

We have our own test case on appeal at the Supreme Court - about the scope and extent of a Principal firm's liability for the conduct of its Appointed Representatives under s39 FSMA. In *KVB*, a regulatory host denies liability for the acts of its AR outside the scope of the AR agreement and the permissions of its principal. (We

2 https://www.appgifffs.org/wp-content/uploads/2024/11/FINAL-Call-for-Evidence-Report-PUBLIC-1.pdf

3 https://www.fca.org.uk/publication/correspondence/fca-letter-new-approach-support-growth.pdf

4 https://www.fca.org.uk/news/press-releases/fca-seeks-further-views-enforcement-transparency-proposals

look forward to discussing the case at forthcoming roundtables for networks and regulatory hosts). For now, Lucy has commented on the Consumer Duty's impact on claims and complaints and the FCA's root cause analysis review.

The FCA is also calling on general consumer law. As Adrian (our consumer contracts specialist) explains, the FCA has a Consumer Rights Act contract review team checking post-Consumer Duty compliance with wider consumer law requirements.

Regulation

As ever, there is a (frankly overwhelming) smorgasbord of regulatory change and issues to report. We found last year exhausting and can only sympathise with our clients for whom the coalface must have felt unbearably hot at times.

Consumer Duty defines everything (and nothing) now. One year on and Dear CEO letters abound. Platforms are now fair game like the distributors who use them. Our piece last year on their 'new' (and surprising to many) role as gatekeepers of the retail investment market is still highly topical. The risks non-advised distributors are being invited to take under the AGBR remain undefined and uncertain. The shifting focus towards guided pensions solutions is welcome. The redress framework review will likely be too late for some who face intolerable liabilities for DD failings in relation to clients' NSA holdings. The read across from SIPP operators is explicit and the legal certainty expected within the Pensions Regulator and Pensions Ombudsman's regime is also under threat, with evolving thinking about the responsibilities of trustees.

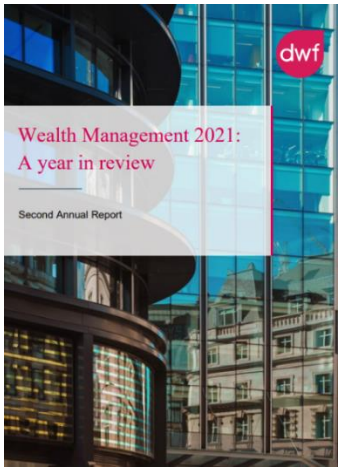
In large part prompted by regulatory scrutiny, the platforms segment of the market has come together to form the Platforms Association, of which we're proud founder members.

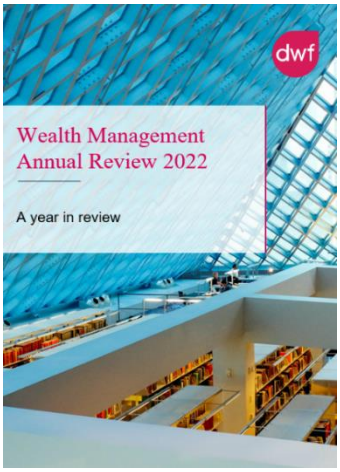
Prudential regulation, under IFPR, is very much in vogue. We covered the 'polluter pays' proposals for PIFs last year and here we have expert insights into everything MIFIDPRU from our resident accountant and prudential consultant, Harry.

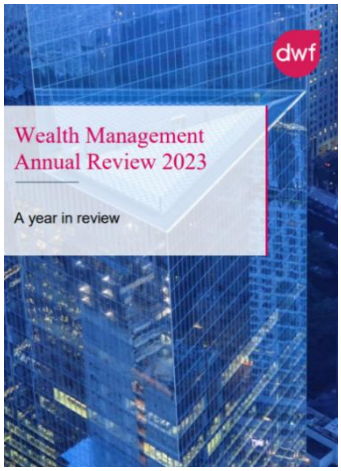
The ongoing services and adviser charging review – aligned with the FCA's consolidator review and its implications for prudential regulation of (mostly PE-backed) funding structures – was my main preoccupation in 2024 and the subject of my article here. Justin has written about PE M&A activity.

We look forward to continuing to support the retail investment market with all its various regulatory needs and challenges in 2025.

Contents







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Why prudential matters

The third anniversary of the UK implementation of the Investment Firm Prudential Regime (IFPR) marks an opportunity to reflect on where the wealth and investment management sector as a whole is versus the FCA's requirements on prudential matters. Whilst we observed growing maturity and understanding amongst firms in 2024, there are still likely a number of areas where work remains 'in progress' when compared to the FCA's report on its IFPR implementation observations in 2023[5].

2024 was a busy year for us in relation to IFPR, Internal Capital Adequacy and Risk Assessment (ICARA) and MIFIDPRU compliance, providing support to our clients and culminating in our hosting two breakfasts for approximately 20 wealth and investment management firms in Q4 to discuss challenges and best practice. Based on our discussions and interactions across the year, recurring themes emerged in relation to: (i) group structures and prudential consolidation; (ii) the ICARA process as a whole, including 'group' versus 'consolidated' basis and management of key stakeholders; (iii) the calibration of scenarios for stress testing purposes; and, (iv) mixed engagement from the FCA in the prudential space for now, with firms inputting into data gathering exercises and others having more formal engagement, including formal setting of requirements and bespoke scenario-related exercises for certain types of firm.

We expect to see a continuation and the emergence of the below trends in the prudential space for 2025 and beyond.

Increasing prudential scrutiny from the FCA

As made clear in its Business Plan for 2024/25, a key area of FCA focus is reducing the risk of harm through firms' failure by ensuring firms' financial resilience via various prudential means. From our observations, driven either through the passage of time or regulatory interventions, such as Skilled Persons' Requirement Notices, we are already seeing an emerging upwards trend in regulatory engagement and scrutiny of prudential matters. This could take the form of inclusion of prudential concerns within S.166 Requirement Notices or increased Supervisory Review (SREP)-type visits for firms driving formal assessment and setting of Own Funds and Liquid Assets Threshold Requirements. In rare circumstances, we are also aware of the FCA requesting that firms run specific idiosyncratic scenario tests.

Spotlight on group structures

Given historical consolidations of various firms and groups in this market, there are already some relatively complex group structures in place. As firms embark on the acquisition trail in 2025 and beyond, it is likely that there will be not just an increased spotlight on the complexity and 'super visibility' of the group structure and non-UK jurisdictions, as

5 https://www.fca.org.uk/news/news-stories/fca-publishes-final-report-ifpr-implementation-observations

evidenced by the FCA's Finalised Guidance 24/5[6], but also the application of prudential consolidation to these groups. Where prudential consolidation has not historically applied, due to the application of the Group Capital Test, it is possible that this alternative approach could fall away due to the perceived complexity of the group structure in FCA's eyes. This has the potential to increase group-level regulatory capital requirements across the industry.

Definition of capital

We noted that the FCA's Regulatory Initiatives Grid, Interim Update (published October 2024) suggested there will be a Consultation Paper on the definition of regulatory capital for MIFIDPRU firms in Q1 2025. The supporting narrative refers to the need to better align the definition of regulatory capital and make it more applicable to investment firms. What this means in practice is potentially open-ended, and could range from a wider review of the definition of regulatory capital, including what comprises Common Equity Tier 1 or Tier 2 capital, or administrative tweaks to the Handbook; however, it is conceivable that the FCA could use this opportunity to tighten up the definition of eligible regulatory capital, particularly in light of historical concerns relating to the use of offshore debt.

Operational credibility of wind-down plans

This remains an area of mixed standards across the industry, with some firms adopting a more notional / theoretical wind-down exercise, heavily predicated on outdated wind-down plan templates, and others taking a more sophisticated and mature approach, rooted in prior experience and market observations. As is evident from the two rounds of feedback on the implementation of IFPR in 2023, the FCA expects sufficient granularity and detailed assumptions around inflows and outflows throughout the wind-down period. However, our view is that the FCA will increasingly expect firms to have tested or demonstrated the operational credibility of their wind-down plans via simulations or 'war games', as is the case for the FCA's operational resilience requirements.

Focus on redress liabilities

March 2024 saw the publication of the FCA's Consultation Paper 23/24, *Capital deduction for redress: personal investment firms*, requiring PIFs to set aside capital for potential redress liabilities at an early stage. In practice, this would first require them reliably to quantify their potential redress liabilities and then take a deduction to capital resources, formalised via the RMA-D1 Regulatory capital return. Whilst the final form of these rules has not yet been published, it is not inconceivable that the FCA could extend this requirement or similar to MIFIDPRU investment firms at a future stage.

This is not intended to be an exhaustive list, but rather to draw attention to the various paths open to the FCA through its prudential regime for investment firms. Therefore, whilst prioritising the various other regulatory initiatives 'in play', it is important for investment firms subject to IFPR to continue to ensure that financial resilience and prudential matters continue to remain high up their regulatory agenda. As IFPR reaches its third anniversary, the FCA's expectations of its firms will continue to increase as the regime 'beds in' and the macroeconomic backdrop remains uncertain; firms should therefore continue to ensure they are well-placed and have invested sufficient management time and bandwidth accordingly to meet these requirements and expectations.

Harry Howe

Director, Regulatory Consulting

E Harry.Howe@dwf.law

M +44 (0)7518 200 263

6 https://www.fca.org.uk/publication/finalised-guidance/fg24-5.pdf

Wealth Management M&A

2024 saw significant M&A and investment activity in the wealth management sector not just in the UK but also across Europe and in the United States. This continued the upward trend in this sector with corporate acquirers and Private Equity (PE) sponsors exploiting the potential to deliver significant returns from wealth management businesses, whether by way of acquisitions of advisory businesses or DFMs.

There is no doubt that the last few years have seen a veritable 'explosion' in activity in the sector - in 2024, the number of deals in the UK approached the 150 mark, up from the low hundreds in 2023. An ever-growing proportion of these deals were PE investments. Why may you ask? There are of course many reasons, but a key feature seems to be the sheer number of wealth management businesses in the market, which creates multiple opportunities for investment, with PE sponsors competing to secure investment in the most profitable and/or scalable businesses and build consolidated wealth management platforms. The competition in the market has also driven up prices in the sector, a significant development given that challenging macro-economic conditions have led to the softening of deal pricing in other sectors.

The trend looks set to continue for the next 12 months, with deal volumes being driven by what we hope will be prolonged softening of interest rates but also the influx of investment by overseas entities based in more buoyant economic markets, particularly the United States. Technology is also a key factor. Technological advances, including everyone's favourite topic, generative AI, is optimising delivery solutions for wealth manager, reducing delivery costs and enhancing their ability to use data to deliver returns for investors and consumers alike.

So, who are the **key acquirers** in the space?

From the PE sponsor ecosystem, TA Associates and Cinven have made big impressions in the North East with Fairstone and True Potential respectively. Nordic are backing Ascot Lloyd, Oaktree now has Atomos and Close Brothers Asset Management (having bought it out of the bank). Premira is still invested in Evelyn but has sold off the professional services division (to another PE house, Apax) to see Smith & Williamson reborn. Pollen Street already owned Kingswood and has recently taken Mattioli Woods private (much as Inflexion did with our firm, DWF). Lightyear, Sovereign, Preservation, Charlesbank, Copper Street, Cabot Square, Penta and other firms with "Capital"in their names have backed wealth management consolidators (or

It would be fair to say that interest in the space spans the length and breadth of the PE industry, from the big-ticket funds through to their mid-market contemporaries. The fragmented nature of the market means that there is potential for investment across a broad spectrum of valuations and entry levels. In other areas, corporate consolidators such as St James's Place remain active and the large investment banks continue to establish a strong position in the UK market.

As one would expect, investment activity in a consumer driven market does not come without regulatory scrutiny. It would be accurate to say that the UK regulators (principally the FCA) are laser focussed on the sector and are taking an increasingly interventionist stance to protect the consumer. The consolidation of these businesses for growth, driving profitability and, in the case of PE, future disposal at healthy returns does present the risk of an inherent conflict of interest between the interests of the PE investors and those of the consumer.

In October, the FCA's Dear CEO letter to financial advisers and investment intermediaries[7] took some in the market – and particularly their PE backers - by surprise. It included a sub-section entitled "Consolidation" and promised a multi-firm review.

CONCERN 1: DILUTED FOCUS ON CLIENT DELIVERY

Does a focus on driving internal profitability compromise a wealth management business's focus on client delivery?

Namely, will they cut corners and sacrifice optimal client delivery in exchange for growth and profitability – creating a fundamental conflict of interest?

Will there in turn be a pressure on wealth managers to bring their portfolios in line with the acquirer/investors' own investment policy which could conflict with the mandates given to the wealth manager by its clients?

The FCA is particularly focused on retirement income advice and ongoing advice services (both covered elsewhere).

CONCERN 2: FINANCIAL RISK

PE investments are traditionally highly geared. With interest rates being volatile, what impact will the pressure of servicing debt have on wealth management businesses and ergo, the consumer? Will consumers suffer because wealth managers are cutting corners to meet the investor/lender's gearing requirements?

The FCA flagged this in the Dear CEO letter, saying "where acquisitions are funded by debt, you should have a credible plan to service the debt. This should be supported by realistic and stress-tested financial projections. Where you are an investment firm group, you must fully comply with our prudential consolidation rules."

CONCERN 3: GOVERNANCE

Will firms have (or continue to have) adequate governance and controls, particularly if they are being integrated into a large platform? Does the investor and/or its platform have a history of regulatory breaches which may cause concern?

The FCA reminded firms it expects them to "ensure the delivery of good outcomes is central to your culture. Your leadership, governance, oversight arrangements and controls should be effective, adequately resourced, and commensurate with your growing size and complexity".

These are live issues - and there are examples of transactions that regulators have either blocked or interventions by supervisors to require specific corporate and prudential structures. Some have slowed or paused M&A activity whilst ensuring better integration of their platform before looking to expand further. With increased borrowing costs for some, and others coming to the end of their funds' investment cycles, we can expect plenty of secondary activity and some stressed sales. In one high profile case, IWP reportedly owed £147m in loans and accrued interest to private credit backer Ares and was bought by Ares-backed Titan Wealth.

7 https://www.fca.org.uk/publication/correspondence/portfolio-letter-advisers-intermediaries-2024.pdf

These businesses will also see increased regulatory scrutiny throughout the term of ownership and investment, with the regulators conducting ongoing reviews of consolidation in the market as a phenomenon and the businesses themselves to ensure that suitability and ongoing service standards, for example, are met. So, investors can expect regular examination of internal governance and the financial health of wealth management businesses to ensure compliance.

That being said, these should not be seen as barriers to entry into the wealth management market. Having a full understanding of the regulatory landscape before embarking on investment into the sector will help investors to mitigate the risks associated with investment. The pursuit of growth and returns on investment will need to be continuously balanced with the duty to the consumer but, as the large volume of activity in the sector demonstrates, these risks are manageable and do not, if managed properly, preclude successful investment by PE funds and others into the space.

Justin Edgar

Partner, Corporate & Private Equity

E Justin.Edgar@dwf.law

M +44 (0)7725 625 307

The Consumer Duty's impact on claims and complaints

The Duty came into force on 31 July 2023 for open products, and 31 July 2024 for closed products, setting new standards of protection by requiring firms to act to deliver good outcomes for retail clients. It is a proactive duty, requiring firms to take action to put customers at the heart of their business, to offer products and services which are fit for purpose, and which represent fair value. That action includes monitoring, assessing, and dealing with claims and complaints.

The Impact of the Consumer Duty on complaints

The Duty requires that where firms identify - through complaints, internal monitoring or from any other source – that retail customers have suffered foreseeable harm as a result of acts or omissions by the firm, they must act in good faith to take appropriate action to remedy the situation, including providing redress where appropriate (PRIN 2A.2.5). This principle amplifies the root cause analysis rules in DISP 1.3 since the PPI 'scandal'.

In December, the FCA published a review of its findings into firms' approaches to complaints and root cause analysis , providing examples of best practice, and areas for improvement, based on a review of 40 firms. The FCA highlighted three key areas where firms need to improve: data analysis; taking action based on complaint insights; and assessing and measuring the impact of these actions

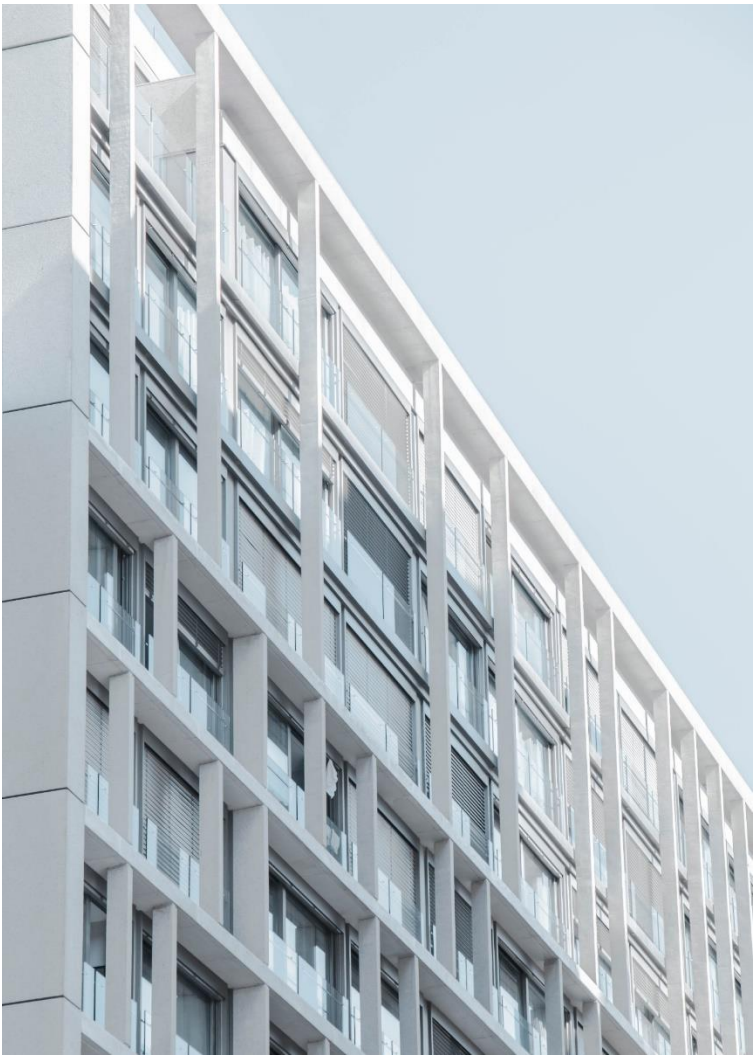
Collecting and assessing data

Tracking data, and monitoring the outcomes that customers are experiencing, is an essential part of meeting the requirements of the Duty, as it allows firms to identify patterns. The FCA found that firms, generally, were capturing data in order to understand the harms that customers were experiencing. However, the quality of the data captured by firms varied. Examples of 'best practice' included firms which had developed enhanced MI dashboards linking data on complaint volumes, complaint outcomes and FOS complaints back to the Duty, allowing firms to carry out deeper analysis of the root causes of complaints. Firms which prepared detailed data packs which included a range of data points and set out the root causes of complaints and actions the firm was taking were more likely to have meaningful discussion, and take action as a result of data gathering. Some firms tracked social media feedback alongside their own data to see if there were common 'themes' underlying complaints. Others used external insights, such as FOS decisions, to identify themes that might cause potential harm.

The FCA criticised firms which did not capture complaints metrics and data with sufficient granularity to capture outcomes for different groups of customers, including consumers with characteristics of vulnerability. Without sufficiently granular data, the FCA considers that it is difficult for firms to monitor whether any groups of customers are receiving worse outcomes than others. The FCA recognises that smaller firms with fewer complaints will have less data – but those firms should identify other opportunities to capture insights, such as FOS complaints data and decisions, to help identify potential harms.

Root cause analysis

Most firms had a framework in place and clear internal policies and processes for carrying out root cause analysis (RCA). In the best cases, firms made expectations clear by creating 'action plans' with designated owners, deadlines and remediation actions. However, in other cases it was not always clear that firms were taking action after identifying harm; or where changes had been made, the impact of those changes had not been followed up or monitored. The completion of the RCA should not be the 'goal' when delivering good customer outcomes – firms must have monitoring systems in place, and should be able to evidence the impact of the changes made as a result of identifying harms through RCA. In other cases, the RCA process was too high-level, and did not effectively identify trends and systemic issues, or was geared up for operational purposes (such as ensuring the firm had sufficient resource to answer complaints) rather than considering how the data could improve customer outcomes.



Governance and leadership

The Duty must be reflected in firms' strategies, governance, leadership and people policies, including incentives at all levels. Controls and key processes should be designed so that firms can identify where they are not complying with the Duty.

The Board should ensure the Duty is being considered in all relevant contexts, and that the firm takes appropriate action to rectify the situation, including providing redress where appropriate. A 'Board Champion' should challenge and prompt consideration of whether decisions need to be made to help improve outcomes for customers, and there must be appropriate management controls in place to ensure there is adequate oversight of complaints management, and decision-making relating to complaints and redress.

Most firms had clear organisational structures and clear overall responsibility for complaints. In the best cases, firms had clear escalation routes and accountability, and data was being appropriately presented and scrutinised at Board level. In other cases, the FCA observed that it was not always clear who was responsible for complaints – data was being sent to committees as a 'tick'box' exercise, rather than being used to engage with issues and drive change. The FCA expects Board minutes to reflect not only discussion of complaints, but detailed discussion, with consideration of what actions need to be taken, with sufficient scrutiny and challenge. Ideally, the Duty should be a standing agenda item at committee meetings.

The impact of Consumer Duty on FOS complaints

The requirements of the Duty have changed the FOS's approach when it considers what is fair and reasonable in the individual circumstances of each case. We are already seeing complaints upheld by reference to firms' failure to prevent foreseeable harms. The Duty requires firms to communicate with their customers and to ensure communications are likely to be understood, so that they can make timely, properly informed decisions about products and services. FOS data indicates that poor administration and customer service continues to be one of the biggest drivers of complaints, including

lack of timely support or broken promises. The FOS has indicated that where customers complain that the information they have received about a product is unclear, it is no longer sufficient for firms to point to the terms and conditions – instead, firms should revisit how they are describing products to customers, and consider whether customers are fully supported on their customer journey, or if they may need contact, reassurances or reminders. The FOS expects firms to focus on finding solutions, rather than justifying why certain outcomes are not possible. The Duty puts a strong emphasis on delivering support to meet the needs of vulnerable customers – building on existing guidance for firms and obligations under the Equality Act. Where firms rigidly stick to standard processes, they are likely to be criticised by FOS for failing to consider the Duty.

The Duy increases firms' obligations to comply with, and have regard, to FOS decisions. The FCA's guidance on the Duty (FG 22/5) even states (at para 5.17): "*Where the ombudsman service has made a decision relevant to the case(s) at hand, we will consider a firm to be acting in bad faith if it delays paying redress where this is due but instead waits for the ombudsman service to make a further decision*". This runs contrary to the subtext of the FCA and FOS's redress framework review, launched in November with a 'call for input' into modernising the redress system[8], and the stated aim to "*prevent the escalation of issues that can result in mass complaints and create significant redress liabilities for firms*".

Consumer Duty going forward in 2025 and beyond

In July 2024, a year after implementation of the Duty, Sheldon Mills, FCA Executive Director of Consumers and Competition, observed that the Duty was having a tangible impact on consumers, with firms developing new data and metrics to understand their customers, tracking those who fall outside of their target market and conducting outreach or implementing intervention measures – in other words, preventing harm.

The FCA's key area of focus for 2025 include embedding the Duty and raising standards; enhancing understanding of value outcome; and realising the benefits of the Duty. Ongoing supervisory work is likely to be increasingly focussed on the Duty, into 2025 and beyond. In the wealth management sector, the FCA has also repeated its plan to engage with firms failing to identify vulnerable customers. As we move towards the second anniversary of the Duty, it is likely that we will start to see the FCA take regulatory action against firms that have failed to implement the Duty as it considers appropriate. Where the FCA treads in cases of poor conduct or consumer outcomes, liabilities (whether from claims and complaints or past business reviews) tend to follow.

The FOS faces major challenges in 2025, aside from the tidal wave of motor finance commission complaints damned up or about to crash over the credit market after the Court of Appeal's decision. In the investment advice market, FOS's approach to ongoing service complaints will be closely watched by firms dealing with the fallout from the FCA's review. With popular reforms introducing fees for CMCs, and claimant lawyers beyond the scope of FCA regulation, firms are also reliant on FOS to stem the tide and enable them to draw a line under liabilities, including any mass redress events. It must deliver quick and informal justice whilst under scrutiny like never before.

Lucy Tolond

Partner, Financial Risks & PI

E Lucy.Tolond@dwf.law

M +44 (0)7514 309 978

8 https://www.fca.org.uk/news/statements/modernising-redress-system

Commissions: Assessing the impacts of the Motor Finance decision on Wealth Managers

The Court of Appeal's decision of 25 October in *Johnson v FirstRand Bank Ltd (London Branch) (t/a MotoNovo Finance)* [2024] EWCA Civ 1282 [9] on commissions in the motor finance sector sent shockwaves through the consumer credit market and could have significant implications beyond the motor finance industry in other areas of retail financial services.

Many areas of the UK economy operate on the basis that customers receive services from intermediaries, for which they only pay indirectly via the cost of the goods and services they purchase from suppliers. In doing so, they rely to some extent on the intermediary to 'steer them right', but one might believe few people would imagine that a salesperson owed them a legal duty to provide them with impartial advice.

Yet that is, effectively, what the Court of Appeal said is the case for second hand car dealers who introduce customers to motor finance companies. Until the judgment, it was assumed that credit brokers had an independent role in acting between customer and funder. However, the Court of Appeal took a very different view; effectively equating any credit broker receiving commission with a broker specifically appointed by a customer to source appropriate finance.

This being so, credit brokers are now to be regarded as playing a fiduciary role in many finance transactions, unless they have made it entirely clear to a customer that they cannot provide impartial advice. If they do take on that role, commission paid would create a conflict unless the customer has given informed consent to its receipt. In both cases, the level of disclosure required would need to cover all material facts, including the nature of the relationship with the funder and the amount of the commission payable.

Such disclosure goes far beyond current regulatory expectations and FCA responses to the issue are eagerly anticipated. The FCA's support[10] for an expedited Supreme Court appeal was unsurprising in the circumstances.

However, the problem goes beyond credit broking. In theory, the same logic would apply to any form of intermediated activity, both inside and outside financial services markets. Indeed, any form of commission-based intermediated sales activity could be affected.

The main reaction from the credit industry, and indeed the wider financial services industry, has been disbelief, and in the end, customers will pay the cost of claims and the additional compliance this decision could create.

The use of commission arrangements in the financial services sector has for some time now been the focus of much attention from regulators and claims

9 https://www.bailii.org/ew/cases/EWCA/Civ/2024/1282.html

10 https://www.fca.org.uk/news/statements/supreme-court-motor-finance-announcement

management companies, but to argue that all such arrangements are inherently wrong is surely misguided.

Potential implications across financial services

This judgment follows a series of recent decisions in respect of brokers receiving commissions in sectors across financial services. These establish the existence of fiduciary or similar duties that brokers hold when arranging finance on behalf of customers, cementing the implications of the *Johnson* decision as wider than motor finance alone.

These include the High Court decision in *McHale v Dunlop and another* [2024] EWHC 1174 which found a broker introducing investment opportunities breached the fiduciary duty he owed to the investor as a result of enhancing the opportunity by offering to pass on a portion of the commission received, and by failing to provide an honest and truthful account of the total sum of the commission payable.

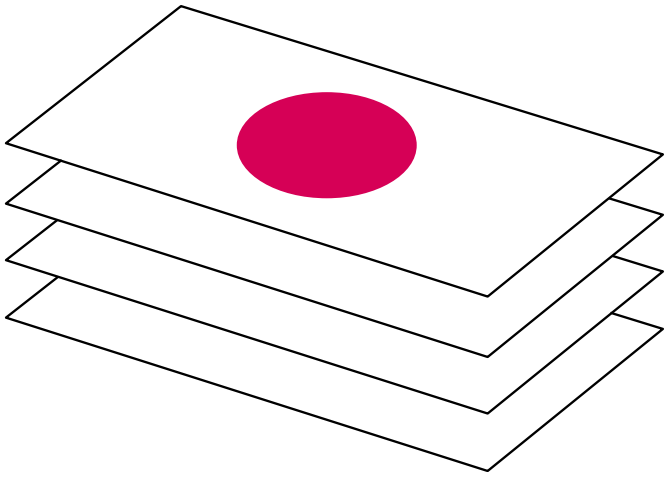
Such a fiduciary duty was also established in respect of brokers introducing CFD investors to financial institutions in *Medsted Associates Ltd v Canaccord Genuity Wealth (International) Ltd* [2019] EWCA Civ 83, where the broker had impliedly represented that the terms on offer were competitive, causing the customer to place their trust and confidence in the broker.

Other cases such as *Wood v Commercial First Business Ltd & ors and Business Mortgage Finance 4 plc v Pengelly* [2021] EWCA Civ 471 and *Nelmes v NRAM Plc* [2016] EWCA Civ 491 (each concerning secret commissions in respect of loans), focused on the 'disinterested duty' the brokers owed to provide information or advice on an impartial basis when acting on behalf of a customer. There is some confusion as to the extent this differs from the fiduciary duties otherwise referenced, with the judgment in *Wood* stating that it is the content of the duty (rather than the label) that matters, and that references to 'fiduciary' in precedent cases were only used in a 'loose sense'. In any event, by accepting commissions without sufficient disclosure, the brokers were found to have breached their duties to the customers, giving rise to redress liability.

The judgments do acknowledge various limitations in each case defining the parameters of the duties owed by brokers and how they arise. Relevant factors include the extent of disclosure given about the commissions, the level of sophistication or vulnerability of the customers, the expected knowledge of the customer in the circumstances and the existence of any actions taken to 'enhance' the relationship.

However, whilst each case is determined on its own circumstances, the build-up of judgments concerning duties owed by brokers and the resultant liabilities when accepting secret and half-secret commissions is making it harder for many established financial services business arrangements to continue operating in the same way as they have before.

Despite the uncertainties created by the judgments, these cases, culminating in *Johnson*, are causing businesses across financial services, such as in insurance, mortgages and pensions, to reassess business strategies to consider how best to protect themselves going forward, as well as assessing their back book risks and setting aside significant amounts for related liabilities. In doing so, many firms will opt for a broad interpretation of their duties to ensure they are operating on safe ground. This may involve insisting on making maximum disclosures at the earliest possible stage and ensuring formal customer consent is obtained prior to paying or receiving any commission.



Impact on Retail Investment Industry

Post RDR Position

So far as the investment advice sector is concerned, although compliance with the post Retail Distribution Review (RDR) rules is not, on its own, sufficient on the basis of this Court of Appeal judgment, it should, as a matter of fact and law, be so.

The rules implemented in 2013 following the RDR require financial adviser firms to ensure clients are aware of how they are paid and the applicable fee structure, alongside prohibiting the receipt of commissions and similar benefits in connection with a firm's business of advising. The post-RDR FCA guidance has been clear that 'advisers must discuss up-front how they will be paid and agree it with their client, rather than being paid by commission'.

Consequently, this Court of Appeal judgment likely does not impact arrangements that have been put in place in the post-RDR environment and are compliant with those rules, as no commission, secret or otherwise, will have been received and any payment will have been disclosed and agreed to by customers.

Potential Issues

Commission linked to pre-RDR arrangements

However, although commissions in the context of investment advice have been prohibited for post-RDR arrangements, the rules provided an exception for existing pre-RDR arrangements. This allows firms, under the FCA rules, to continue to accept a commission or similar benefit where this is clearly linked to advice given, or a transaction made, prior to the implementation of the RDR rules (in 2013).

Consequently, advisers that have relied on this exception and have continued to receive commissions or similar benefits in relation to pre-RDR investment advice or transactions may now fall foul of the Court of Appeal decision. Notwithstanding that the judgment addressed the commissions received by car finance brokers, the establishment of a fiduciary or disinterested duty to act entirely in the interest of a client likely also makes the receipt of a commission by a financial adviser without informed and express client consent similarly problematic and open to challenge. This is notwithstanding the position under the applicable rules of the FSA (as was).

Although these always required client disclosure of commissions received even prior to the RDR revisions, express client consent was not a requirement, creating a potential discrepancy with the standard now imposed by the Court of Appeal. As result, firms that have received such commission in reliance on the position under the FCA rules now face a risk of claims arising in respect of these, which they may have to defend with evidence of the client's agreement.

Where such commission is received in connection with the provision of an ongoing service, the risk is likely to be lower, provided the commission has been fully disclosed to clients as part of the ongoing disclosures in line with the FCA rules. Although this does not necessarily meet the consent standard imposed by the Court of Appeal, the ongoing course of dealing may be seen as evidence of client consent to the disclosed commissions.

That said, the level of consent needed may depend on the sophistication or status of the relevant clients. As in *Medsted*, where impacted clients have sufficient

experience with the relevant investment products/services, more limited disclosure is acceptable. Therefore, in that case, disclosure that a commission would be paid without informing clients of the specific amounts was sufficient to satisfy the duty of the broker to the investors. Consequently, the question as to whether any ongoing or other disclosure, and implied client consent, satisfactorily meets the standard required may depend on the status of the affected clients, resulting in some ability for firms to rely on disclosure alone in appropriate circumstances.

Client transfers and novation on platform

A further (theoretical) impact in the retail investment sector may be where clients are or have been transferred between financial adviser firms. In such cases, it is generally required to obtain client consent prior to the new adviser providing its services and receiving any charges. This ensures that the client is fully aware of and agrees to the change in their advisory services (in accordance with COBS 8(A) and evolving FCA guidance on such client transfers).

Additionally, when facilitating such transfers and the payment of adviser charges and/or other fees to new service providers, platforms are required to obtain and verify client instructions and consent for the payment of adviser charges to the new adviser for each client.

However, it is not uncommon for such consent not to be obtained for every client. In many cases, where express consent is not obtained or it is impractical to do so, firms instead rely on a negative consent mechanism with a right to cancel should objections be raised later. While this approach carries its own regulatory risks, firms exposed to such scenarios may now also find themselves at risk of failing to comply with the duties that may arise under Common Law. This could occur by receiving or facilitating a 'secret payment' without the required client consent, similar to the commission received by motor finance brokers in *Johnson*, making firms liable to refund these should claims be raised.

However, although this is a logical application of the principles now established by the Court of Appeal to this scenario, given the existing regulatory framework that applies to require such consent in the first place, the risk faced by firms is, in reality, not likely to be materially increased as a result of the Court of Appeal judgment.

Acquisition Consideration

Further to the above, fallout from the law as stated by the Court of Appeal may also be felt where adviser firms have been acquired, for example by consolidators. In these scenarios, acquiring firms often wish to incentivise advisers in some form to continue with and enhance their business performance in the provision of financial advice and/or increasing client assets under management.

Straightforward commissions linked to such services or based on client volumes are already largely prohibited under the FCA's inducement rules, and the strict rules and guidance concerning managing conflicts of interest in the context of making personal recommendations. However, some acquiring firms have sought to implement less direct incentive payment structures, usually involving conditional deferred acquisition payments (from and to unregulated parties to the deal) rather than a payment directly linked to client recommendations or volumes.

As with the client transfer issues above, such structures may carry their own regulatory risk. However, even where compliance with the FCA's rules can be shown to have been achieved, as a result of the judgment of the Court of Appeal, firms using such mechanisms could face a separate risk of breaching their duties of impartiality to clients where the receipt of such incentive payment is not clearly disclosed, and expressly consented to, by relevant clients (as is typically the case). This risk is much reduced by the course of dealings between advisers and clients (as above) and because it is usually very difficult to link any particular payment to any particular client.

Introducer Fees

Investment firms may also be affected by the Court of Appeal judgment where they have paid introducer fees for client referrals, typically from solicitors, accountants or estate agents. As with incentive payments, such fees are already covered by the FCA's inducement and conflict of interest rules (and equivalent rules imposed by other regulators like the ICAEW and SRA). However, even if these introducer fees are structured to comply with the FCA's rules, they may still not be fully disclosed to and agreed by clients.

Where this is the case, the impact of the Court of Appeal ruling could result in such fees being regarded as a secret or half-secret commission, breaching obligations in favour of clients. Consequently, investment firms might face claims to refund these fees paid to introducers.

That said, it is possible that in seeking to ensure compliance with the FCA's rules, or the mirror obligations which commonly apply to referrers under their own regulations, disclosure was provided to customers of such introducer fees. Without active client consent this may not satisfy the standard required by the Court of Appeal ruling, but it may go some way to mitigate any risk (particularly with evidence of consent through course of dealings).

Conclusion

Regardless of any material issues for the investment sector, the Court of Appeal judgment will likely create implications in other areas of the financial services industry, including mortgage, insurance and protection business arrangements.

Although these will similarly be governed by their own applicable rules, the Court of Appeal has created a new standard of obligation with respect to customers such that compliance with the FCA rules alone may now not be enough to eliminate risks of legal challenges where fees and commissions are not fully disclosed, and consented to, by customers.

This reality, and the extent of the possible knock-on effects as described in this analysis, is unlikely to have been the intention of the Court of Appeal when issuing this ruling. Notwithstanding possible revisions upon appeal to the Supreme Court, these uncertainties and potential retrospective financial liabilities, highlight the need for the FCA and lawmakers to address how consumer rights and protections are balanced against the need for legal certainty to protect the financial services industry and foster future investment.

Simon Lewin

Solicitor, Investment Funds & Financial Services Regulatory

E Simon.Lewin@dwf.law

M +44 (0)7926 697 722

Ongoing advice services review – getting what you paid for...

For much of last year, we worked with firms to respond (literally and hypothetically) to the FCA's challenge to the advice market to demonstrate they are delivering fair value, by ensuring clients paying ongoing adviser charges are receiving an ongoing service, including an annual review. Due by the end of 2024, we're now waiting on tenterhooks for the FCA's report and directions as to next steps.

What's happening?

So far, with much publicity, SJP and Quilter have reportedly been reviewing their client records for the last few years, with the help of skilled persons and under close supervision by the FCA, to identify shortcomings in their advisory services and where refunds of fees are due. SJP has estimated its exposure at nearly half a billion pounds. Others have been watching on nervously.

On 15 February[11], the FCA sent 20 of the 'larger' firms 2 apparently innocuous questions and a request for data, with a sting in the tail, as follows:

Q1*. Have you reviewed the delivery of ongoing advice as part of your Consumer Duty work, in particular when assessing fair value? Yes/No*

Q2*. If you did review it, please also confirm if you made any changes? Yes/No.*

Q3*. Please complete this table:*

Time period 1 Jan - 31 Dec	Number of clients due a suitability review as part of your financial advice ongoing service	Number of clients who received a suitability review as part of your financial advice ongoing service	Number of clients who paid for ongoing advice but whose ***fee was refunded as the suitability review did not happen***
2023			
2022			
2021			
2020			
2019			
2018			
2017			

[emphasis added]

The FCA review team is working with the firms involved to verify the data, before deciding on next steps and determinative questions like what constitutes an ongoing service for which ongoing fees are earned, what's required for a periodic assessment of suitability, is an annual review meeting required, when might a refund be due and how far back should firms look and can complainants go?

11 https://www.fca.org.uk/news/statements/requests-information-firms-delivery-ongoing-advice-services-consumer-duty

The issue

Since RDR in 2013 and the advent of 'adviser charges' in place of (trail) commissions for retail investment product recommendations, the FCA has repeatedly stated that ongoing fees should only be charged where an ongoing service is provided. There is much debate about 'periods of grace' or how to handle disengaged clients who don't respond to annual review requests, but where clients were provided very little or no personalised service for way more than 12 months, it will be increasingly difficult to argue an ongoing service has been provided and the associated fee earned. Legal arguments about there being no loss caused, except by a 'total failure of consideration', probably won't help defend fee refund complaints.

We hesitate to quote rules in the WMAR but these are critical. The overlap between them – and the client agreement, with terms of business, which makes up the third leg of the ongoing service stool – will determine the specifics of each firm's situation:

- COBS 6.1A.22 (since RDR in 2013) says "A firm must not use an adviser charge which is structured to be payable … over a period of time unless … the adviser charge is in respect of **an ongoing service for the provision of personal recommendations or related services** and … the retail client is provided with a right to cancel the ongoing service …"
- COBS 9A.3.9 (since MiFID II in 2018) states "investment **firms providing a periodic suitability assessment shall review … the suitability of the recommendations given at least annually**". [emphasis added]

What's expected?

The FCA has made its expectations pretty clear over the years, with factsheets and webpages on adviser charging including, for example, "you can only take an ongoing charge if you are providing an ongoing service - for example regularly reviewing the performance of a client's investments" and firms "must ensure [they] have robust systems and controls in place to make sure…clients receive the ongoing service [firms] have committed to".

In its 2017 Supervision Review Report: Acquiring Clients from other Firms[12], the FCA noted, as part of its assessment of post-RDR consolidation, that "*ongoing adviser charges can only be received by a firm that is providing a proactive ongoing service to a client. This means that, where a firm is aware that the ongoing service is not, or cannot, be provided to an individual client, it should ensure that the ongoing charges are stopped and, where appropriate, refunds made*." This is the first recorded reference to a refund obligation of which we're aware.

Although on the FCA's agenda for some time, the current focus on ongoing services has come after the implementation of the Consumer Duty in July 2023.

In its Dear CEO letter on its expectations for Wealth Management & Stockbroking Firms (of 8 November 2023[13]), the FCA noted they "*continue to see firms charging for services which are not delivered (such as ongoing advice)…and providing a product or service which does not align with the needs of consumers*".

Then, in an example of 'regulation by webinar' (held on 6 December 2023), the FCA said that firms need to be "*continually reviewing […] charging structures to make sure they do continue to provide fair value*", and that the FCA have seen good practice in the form of firms "*giving refunds for services that have not actually been delivered and have not provided good value*".

Conflating the ongoing fees for ongoing services rule (COBS 6) with the periodic assessment of suitability rule (COBS 9) would create too simplistic an approach. Mixing concepts like fair value (post Consumer Duty) with the requirement for compliant

12 https://www.fca.org.uk/publication/research/supervision-review-report-acquiring-clients-other-firms.pdf

13 https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-fca-expectations-wealth-management-stockbroking-firms.pdf

MiFID II suitability reviews risks treating all propositions the same and forcing firms, in effect, to build their business models solely with the rules in mind.

That cannot be good for innovation and attempts to fill the advice gap.

What next?

The FCA said it would feed back before year-end but (at time of writing in January 2025) we are still waiting. Whenever it is, perhaps after a mere update on its ongoing data gathering and verification work with the 20-firm initial cohort, the FCA will likely have to decide between three main options:

1. Issue a 'good and bad practice' report, and let firms ensure good outcomes for advised clients as part of their ongoing service delivery and Consumer Duty framework and compliance monitoring;
2. Send a 'Dear CEO letter', setting out its expectations for firms' forward and backward-looking review and remediation work, leaving it to firms to design and deliver their projects, perhaps with SMF attestations about the outcomes and/or under close supervision, with skilled persons appointed where necessary; or
3. Impose a s404 industry-wide redress scheme.

Option 1 would be the most sensible, and consistent with the post-RDR drive to close the advice gap and deliver centralised, simplified, lower-cost and predictable investment products to the mass affluent market.

Option 2 would mean a costly field day for consultants and CMCs.

Option 3 could be disastrous for the market and, ultimately, consumer investors if the FCA imposed unrealistically high standards retrospectively.

What can you do?

Firms should make ready with their (equivalent) data - and check it. They should review their service complaints data and associated root cause analysis and put an end to any overly simplistic (if commercially understandable) approach that might involve full refunds of fees to avoid aggravating clients and FOS case referral fees.

Corporate development teams (and their PE backers) should consider and revise their acquisition strategy and deal documents to ensure ongoing service delivery, and potential refund liabilities, are factored in.

In line with existing product governance and the newer Consumer Duty obligations, firms should be considering their target market and client segmentation and, if and where necessary, identifying smaller client solutions for those for whom the full advice and full costs service may not demonstrably deliver fair value.

The AGBR is unlikely to be the silver bullet but potentially forms part of the solution, with firms who offer lighter touch advisory or non-advised guided propositions looking to acquire smaller clients. Hopefully, the FCA will allow a period of grace for client segments to be found the right home.

Firms should ensure their forward-looking advice processes, policies, data capture and MI – which should be tip-top after the implementation of Consumer Duty in any event - support and evidence the delivery to all clients of the full service they've paid for. Unlike historic suitability concerns, for example, this is core to the business and its value, and no firm can hope to thrive without meeting client and regulatory expectations.

Unfortunately, we are already seeing poor claims management conduct, particularly by lawyers acting under SRA, not FCA, regulation. Firms should prepare their complaints and DSAR processes for the threatened onslaught.

And then wait (not long now) for the FCA's report – with fingers crossed....

Robbie Constance

Partner, Head of Wealth Management Regulatory

E Robbie.Constance@dwf.law

M +44 7545 100 514

Worse the devil you know? Why FCA Supervision presents greater risk than Enforcement

Historically, many firms have been more concerned with the prospect of dealing with the FCA Enforcement division than Supervision. From our experience, this is (increasingly) the wrong way round. We expect FCA supervisory activity will only increase in volume and intensity in the coming years, whilst Enforcement activity will continue to decrease. This is what we have seen with our clients and is replicated in published FCA data.

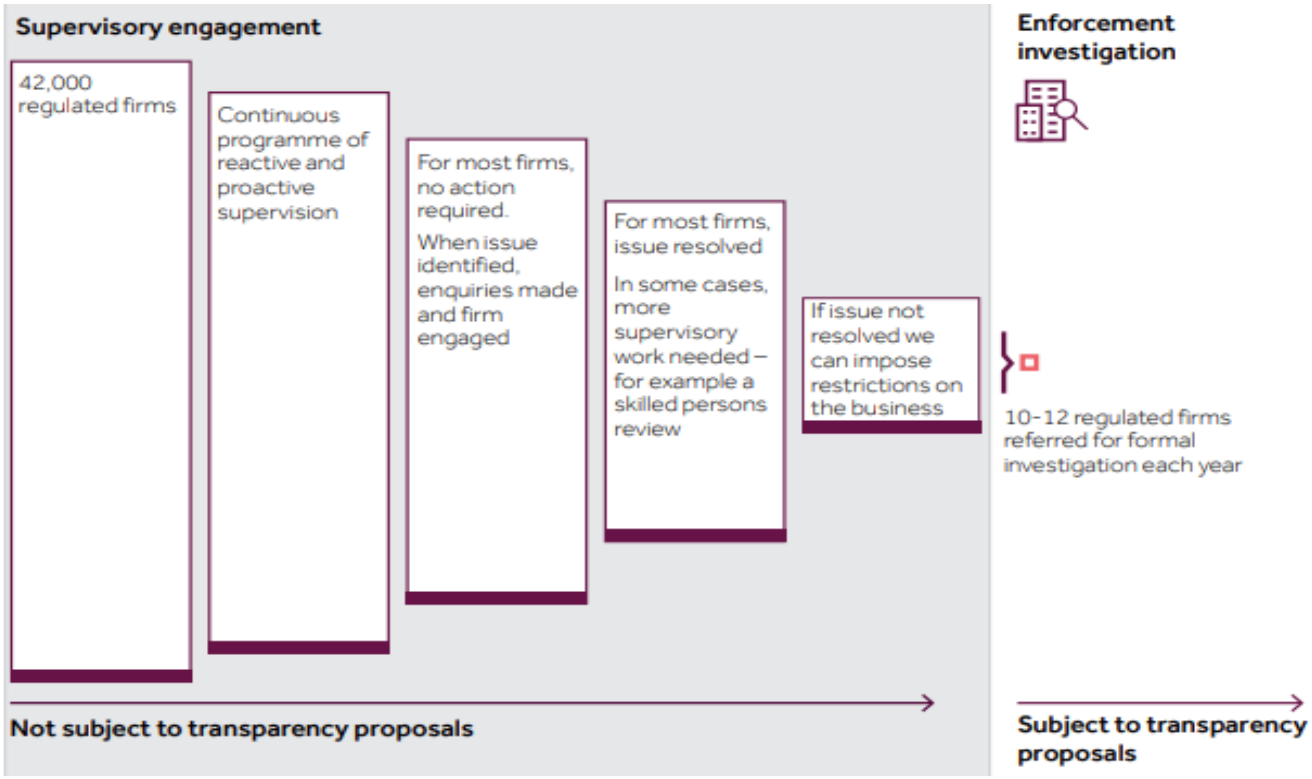
FCA's changing use of Supervision and Enforcement

The FCA appears to be moving away from relying on enforcement investigatory action, with far greater emphasis on assertive supervision and intervention. This matches the FCA's rhetoric about being a data-led and assertive regulator, seeking to prevent harm sooner through proactive supervisory action. This is far harder to do with a backwards-looking enforcement investigation into events often from years before.

One of the first major steps towards this approach was the 2021 change in FCA decision-making powers. Prior to that, the FCA had to obtain approval from the Regulatory Decisions Committee (RDC) in order to impose a Requirement on a firm or amend a firm's permissions.

This acted as a quasi-independent check and balance on the FCA's own initiative powers. It also increased the time and effort it took the FCA to impose such a decision on a firm. Whilst there are still some limitations on individual decision makers, the changes removed any form of independent check and balance. This has increased the speed with which the FCA can take such action (including on a 'without notice' basis).

The drive towards transparency and earlier publicity in respect of Enforcement action is part of the push for quicker, more impactful action with greater focus on preventing foreseeable harms before it's too late. In its recent, revised 'name and shame' Consultation Paper - CP24/2 (part 2)[14], the FCA describes its regulatory model with the following diagram:



This suggests only 10 or 12 regulated firms will be referred for formal investigation by the Enforcement division each year. Explaining this, the FCA says: "*Effective enforcement work reinforces the UK's reputation as a trusted, clean and stable place to do business. That trust is underlined when we investigate thoroughly and at pace, so any wrongdoing can be quickly addressed. To achieve this, we are focusing our portfolio of enforcement cases and aligning it with our strategic priorities. This is resulting in fewer and faster investigations*" and "*We typically open investigations into around 10 to 12 regulated firms each year*". (We note that this refers to firms and not individuals, so this is not the entirety of the FCA's anticipated annual investigations. There are also criminal investigations on top of this (including into unregulated parties).)

In a similar vein, it is interesting to note that open Enforcement 'operations' (which can encompass investigations into multiple parties) have fallen from 220 on 1 April 2023 to 147 as of 28 November 2024. This period coincides with the tenure of the current co-heads of Enforcement and their approach, showing they are decreasing the number of investigations since taking over from their predecessor, Mark Steward. The FCA only opened 25 new operations in 2023/24, compared with 34 in the previous year[15].

The FCA Enforcement Data 2023/24 further supports the focus on supervision. Section 3 sets out

14 https://www.fca.org.uk/publication/consultation/cp24-2-part-2.pdf

15 https://www.fca.org.uk/data/fca-enforcement-data-2023-24

information on the FCA's use of supervisory intervention action and states that "*During 2023/24, the Interventions team advised [Supervision, Policy & Competition division] on 268 interventions cases, where we considered the use of voluntary requirements or our own initiative powers, up from 209 in the previous year*". We can combine this with data provided in the FCA operating services metrics for 2022 and 2023[16] to show the number of intervention cases opened since 2019:

Year	Intervention Cases Opened
2019/20	99
2020/21	187
2021/22	177
2022/23	209
2023/24	268

It appears clear that there is an ever-increasing focus on supervision, with a more targeted approach to enforcement. Whilst FCA enforcement action will remain an important tool for the FCA, firms need to be more alert to the risk posed by FCA supervision. Firms are far more likely to be affected by adverse supervisory action than enforcement action.

Impact of Supervision

In practical terms, and at its most basic, FCA Supervision is any touch point between the FCA and a firm about its day-to-day business. This can range from regular reporting and applications (for CiC or VoPs), to *ad hoc* 'general' queries, and sector-wide questionnaires, all the way through to pointed questions and concerns, which can lead to 'close supervision' and even intervention. Where the FCA has concerns, this can quickly lead to supervisory intervention.

The FCA has a range of intervention powers and options, the most common of concerns for firms are:

- The request for voluntary requirements (so called VREQs) to be agreed by firms (including an effective shut down if agreeing a requirement to cease all regulated activities (which is distinct from having a firm's permissions cancelled));
- The imposition of a skilled person (a S.166 review); and/or
- The FCA can impose restrictions or remove firms' permissions (so called OIREQ or OIVOP) (including an immediate shutdown, without notice).

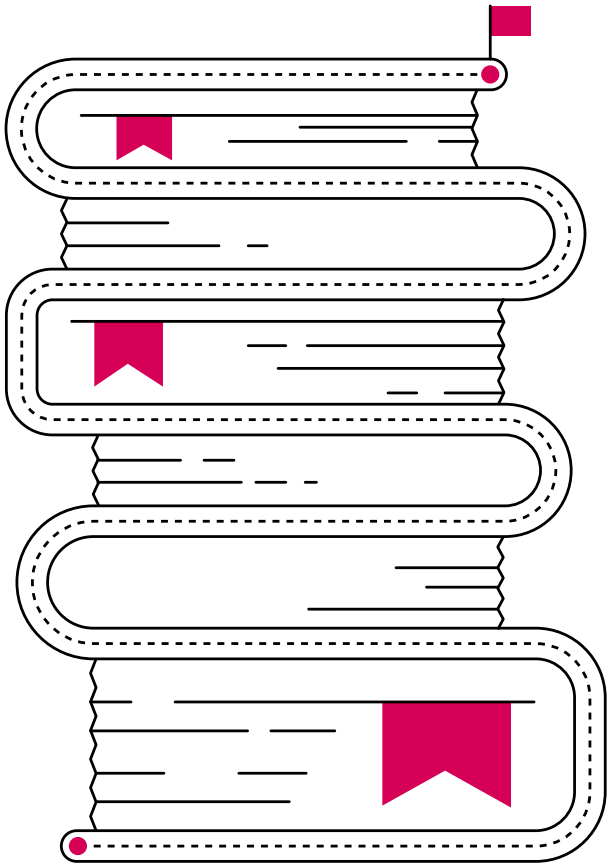
The types of requirements the FCA can impose are almost endless. For example, we have seen restrictions on firms:

- having any dealings with a certain person or entity (directly or indirectly);
- creating and issuing their own FinProms;
- taking on new certified function holders and/or opening new offices;
- requiring them to set aside specific money for potential redress and/or remediation (in addition to regulatory capital)
- asset restrictions which limit how the firm can deal with its own assets without FCA approval (an 'asset retention');
- not to carry on certain business lines;
- to comply with specific rules;
- to take on no new clients (in some or all business lines); and
- the most draconian of them all, not being able to carry on any further regulated activities. This is essentially a shutdown.

16 https://www.fca.org.uk/data/fca-operating-service-metrics-2022-23#lf-chapter-id-enforcement-data-2022-23 - These numbers are derived from combining the own initiative cases with the early engagement cases

All of these requirements will have an impact on the business, albeit some more significant than others. In addition to the direct impact, there are also significant time and cost implications. They are a significant distraction for senior managers. The impact can extend to a large number of operations and/or compliance staff where remediation is required. Publicity of such issues can also cause significant concern amongst staff and potentially clients. There is then the cost of remediation, which may be one-off expenditure (such as legal advice and remedial work) or the need to increase ongoing BAU spending (e.g. increased headcount and/or software solutions for compliance and/or operations). There could be redress costs in addition and, particularly for smaller and mid-sized firms with lighter capital loads, these could be potentially terminal.

Additionally, in reality, removing a VREQ is never a quick process (assuming it can be achieved at all). In our experience, requirements rarely last less than 12 months, and often far longer.



How to deal with Supervision

As with one's health, the best approach is prevention rather than cure. Firms need to appreciate that any correspondence with the FCA runs the risk of follow up. What may appear to be a harmless questionnaire could indicate to the FCA – especially if answered carelessly - that the firm is an outlier. A half-baked response to a general query or a withdrawn SMF application or VoP application can raise concerns. A miscalculation when submitting data can start a chain of enquiry (which cannot always be stopped prior to some form of intervention). This point isn't intended to be scare-mongering – far from it – the point is that firms need to recognise that the FCA will use any and all information about a firm to decide if there are questions it should ask. The more questions the FCA has, the more likely ongoing and difficult supervisory engagement. Simply put, firms should take all FCA correspondence seriously, even if it appears mundane.

This is all the more so for all but the largest wealth management firms that don't have dedicated supervisors and for whom, therefore, every engagement with the FCA counts - and is likely conducted with someone at the regulator who knows little or nothing about the firm.

We advocate firms taking advice from a trusted expert at an early stage of any non-standard supervisory correspondence, but it becomes crucial should you end up facing more significant intervention. There are common pitfalls that firms can fall into where they have not dealt with such processes before. Having someone who can objectively assess the situation and help ensure the right tone is set is often crucial to maximising a firm's chances of minimising difficulties and costs arising from supervisory intervention.

Aaron Osborn

Director, Financial Services Regulatory

E Aaron.Osborn@dwf.law

M +44 (0)7892 701 766

Key Considerations When Reviewing Consumer Terms

The FCA has taken an increasingly assertive stance in scrutinising consumer contract terms. Using its discretionary powers under the Consumer Rights Act 2015 (CRA), the regulator has actively challenged terms it considers unfair, opaque, or overly favourable to firms at the consumer's expense. This aligns with the FCA's broader Consumer Duty, which requires firms to act in good faith, avoid foreseeable harm, and enable customers to make informed decisions.

From our experience advising FCA-regulated firms, we have observed heightened regulatory intervention regarding:

- unilateral variation clauses, allowing firms to amend terms at their discretion;
- restrictions on consumer redress, including clauses that limit a consumer's ability to challenge decisions or seek compensation; and
- complex, jargon-heavy drafting, which obscures key obligations and prevents consumers from making informed choices.

While 'click-accepted' and 'deemed-accepted' terms are enforceable contracts, the FCA has scrutinised their use to ensure that they meet standards of fairness and transparency. The regulator has made it clear that formal consumer agreement alone does not guarantee contractual fairness. Firms must demonstrate that consumers had a genuine opportunity to engage with and understand the terms before accepting them.

This regulatory focus requires firms to take a proactive approach to contract reviews, ensuring not only legal compliance but also clarity, accessibility, and fairness. This article sets out the key considerations that all firms (particularly retail investment firms) must address when reviewing consumer contract terms, incorporating principles from the CRA and the Unfair Terms in Consumer Contracts Guidance (UNFCOG).

The FCA's Approach to Consumer Contract Terms

The FCA imposes sector-specific requirements for financial services firms, going beyond the general consumer protections provided by the Competition and Markets Authority (CMA) under the CRA. The FCA does not assess contract terms in isolation but considers them within the broader regulatory framework, including:

- the Consumer Duty and its emphasis on good consumer outcomes;
- the Principles for Businesses (PRIN), containing the old requirement to treat customers fairly and to communicate in a way that is clear, fair and not misleading; and
- the Conduct of Business Sourcebook (COBS), which includes COBS 8(A) on the minimum requirements for client agreements and COBS 15 on cancellation rights.

Key Areas of Regulatory Focus

The FCA is particularly concerned with contract terms that:

1. Create a significant imbalance in power – Firms have greater legal and commercial expertise than consumers, necessitating fairness safeguards.
2. Lack transparency or clarity – Consumers must be able to easily understand their rights, obligations, and the potential financial impact of contractual terms.
3. Permit unilateral variation without sufficient consumer protection – Firms must provide clear, justifiable reasons for any changes and offer consumers meaningful options.
4. Restrict consumer rights to dispute or exit the contract – Limiting a consumer's ability to challenge decisions, seek compensation, or terminate agreements raises fairness concerns.

Firms should anticipate intensified regulatory scrutiny in these areas and ensure that their contractual terms withstand FCA examination, particularly now that the Consumer Duty should be well embedded and annual cycles of consumer outcomes testing should be underway.

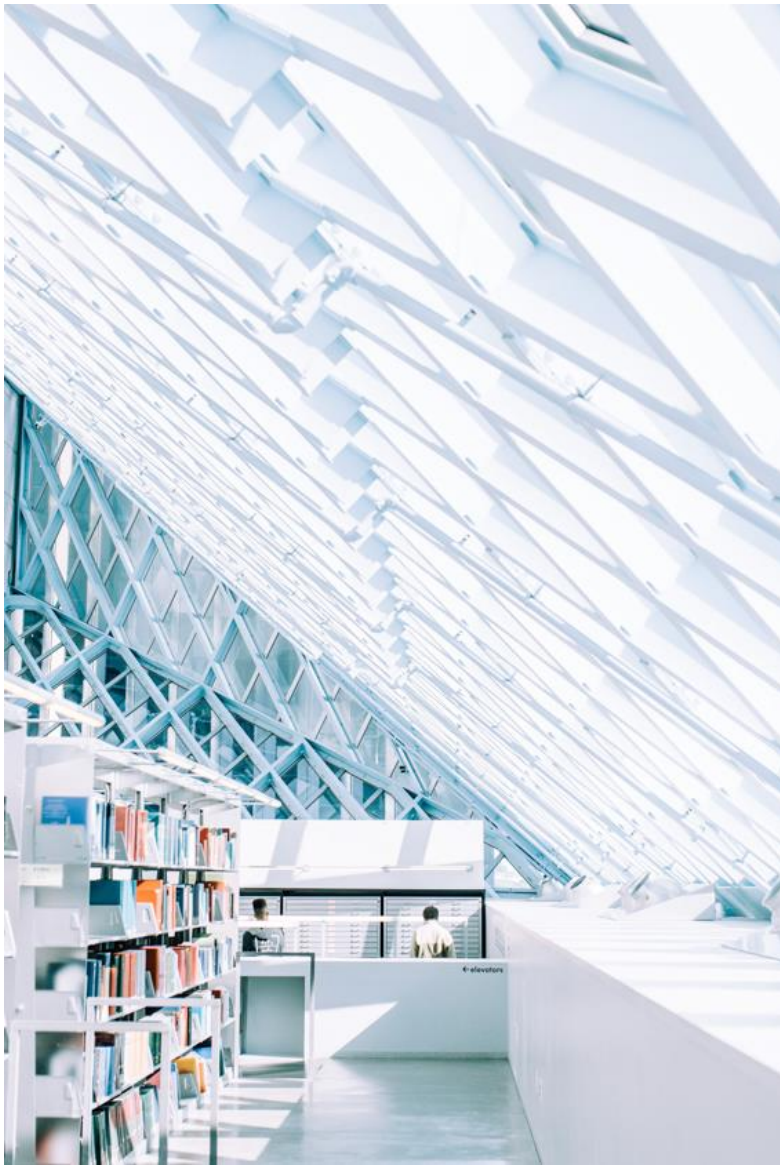
Legal & Regulatory Framework: The Consumer Rights Act and UNFCOG

The CRA sets out the statutory requirements for fairness and transparency in all consumer contracts. Firms must ensure that their terms align with:

- Fairness (s62) – A contract term is unfair if it causes a significant imbalance to the detriment of the consumer.
- Transparency (s68) – Contract terms must be easily accessible, clearly written, and unambiguous.
- The "Grey List" (Schedule 2) – This includes terms presumed unfair unless firms provide strong justification, such as automatic renewal clauses, unilateral variation terms, and disproportionate exit penalties.

The splendidly-named UNFCOG provides further guidance on assessing fairness under the CRA. It highlights that firms must ensure:

- Core terms are prominent and transparent – Key contractual obligations (such as fees, repayment terms, and penalties) must be clear and prominently displayed (in addition to complying with specific rules on fees & charges in COBS).
- Terms do not mislead or surprise consumers – A term is more likely to be unfair if it is buried in the fine print or not brought to the consumer's attention.
- Consumers have a real ability to negotiate and understand terms – Where firms rely on standard-form contracts, the imbalance of power must be carefully mitigated.



Differences in Approach: Retail vs Professional Clients

The CRA does not distinguish between retail and professional clients, as it applies broadly to all consumer contracts. However, within the FCA's regulatory framework, the approach differs significantly between these client groups.

Professional Clients

Under the COBS 3.5.1, professional clients are classified into two main categories:

1. Per Se Professional Clients:

- These clients are automatically considered professional due to their nature or size.
- They include entities authorised or regulated to operate in financial markets, such as credit institutions, investment firms, insurance companies, collective investment schemes and their management companies, pension funds and their management companies, commodity or commodity derivatives dealers, and other institutional investors.
- Large undertakings meeting at least two of the following criteria:
    a. Balance sheet total of EUR 20,000,000
    b. Net turnover of EUR 40,000,000
    c. Own funds of EUR 2,000,000

2. Elective Professional Clients:

- These clients are not automatically considered professional but can be treated as such upon request and upon meeting certain requirements.
- They typically include institutional investors and sophisticated counterparties - but can also be consumers who 'elect up'.
- Elective professional clients must demonstrate a higher level of understanding and experience in financial markets and are subject to a different regulatory approach, assuming they have the knowledge and expertise to make informed decisions and understand the risks involved.

Professional clients are presumed to have a higher level of understanding and are subject to a different regulatory approach:

- There is greater contractual freedom, as professionals are expected to assess risks independently.
- Certain CRA protections may not apply, particularly if the customer is acting in the course of business.
- Firms may use more complex, bespoke contractual terms, provided they remain fair and transparent.

Despite these differences, firms must still ensure fairness and transparency in their dealings with professional clients, particularly for those who still qualify as a consumer and where there is a risk of information asymmetry or power imbalance.

Retail clients are anyone who does not qualify as a professional client and will likely also be consumers.

Termination and cancellation: CRA vs COBS 15

The CRA provides consumers with statutory rights to exit contracts, particularly where:

- there has been a breach of statutory consumer protections (e.g., unfair terms, misleading information, or failure to meet legal obligations).
- goods or services are not of satisfactory quality, fit for purpose, or as described.
- a unilateral variation clause is deemed unfair under the CRA's fairness test.

Where a term restricting consumer termination rights is deemed unfair, it may be unenforceable, meaning consumers can exit the contract without penalty.

- COBS 15 introduces additional consumer termination and cancellation rights:
- COBS 15.2 requires firms to ensure that contract termination rights are fair and proportionate.
- Unreasonable exit fees or onerous notice periods may be challenged as unfair.
- In some cases, consumers must be given a cooling-off period to exit without penalty.
- Firms must clearly communicate termination rights, ensuring they are not obscured in complex contract wording.

Consumer Testing: Ensuring Contract Terms Are Understood

Even if contract terms are legally compliant, they may still be ineffective if consumers do not understand them. The FCA – which has a dedicated CRA team currently reviewing retail investment terms under the Consumer Duty - increasingly expects firms to conduct consumer testing to ensure contractual wording:

- Is genuinely clear and comprehensible.
- Facilitates informed decision-making.
- Does not lead to foreseeable harm due to misunderstanding or confusion.

Best Practice for Consumer Testing

1. Readability Assessments – Use metrics such as the Flesch-Kincaid readability test to measure complexity.
2. Consumer Comprehension Trials – Present key contract terms to sample consumers and assess their understanding.
3. A/B Testing – Compare different contract formats to determine which is most effective in enhancing consumer understanding.
4. Feedback Mechanisms – Use surveys, focus groups, and real-world behavioural analysis to identify common points of confusion.

The Consumer Duty framework reinforces the need for ongoing testing to ensure that contract terms support good consumer outcomes.

Conclusion

Wealth management firms must move beyond basic legal compliance and ensure their consumer contract terms are fair, transparent, and properly tested for consumer comprehension. As the FCA continues to review Consumer Duty implementation, perhaps with an eye to potential interventions, firms that proactively assess, refine, and validate their contract terms will be best placed to withstand regulatory scrutiny and foster long-term consumer trust.

Adrian Davies

Associate, Commercial (Consumer Contracts)

E Adrian.Davies@dwf.law

M +44 (0)7759 118 253

Pension focus

Developments in personal pensions warrant their own dedicated section of this year's Annual Review.

Change in the pensions market over the last few years and those expected in the coming years has never been so significant and fast paced. Some may argue pension freedoms in 2015 were more significant - in reality, that has laid the groundwork for the current focus and, in part, explains why there are an ever-increasing number of FCA, Pensions Regulator (TPR) and Government reviews, changes and initiatives in the pension space. It has taken the various regulators the best part of 10 years to start making meaningful reform in light of pension freedoms.

We have set out below a brief overview of the pensions market and specifically its move away from defined benefit (DB) to defined contribution (DC) pensions. We then have four individual articles from various authors covering:

1. FCA Discussion Paper (DP 24/3) – 'Adapting our requirements for a changing market';
2. the FCA's work in the changing retirement income advice market;
3. challenges faced by SIPP operators relating to toxic or impaired assets; and
4. Long Term Asset Funds and the increased focus on pension funds investing in less liquid assets.

Pensions Overview

In December, the FCA estimated that the UK DC pensions market had c. £1.4 trillion in assets[17]. DWP expects this to continue to grow.

SIPPs make up roughly a third of this market, with 5.3m registered in the UK and holding around £566 billion AUA. Changes in the way the UK population plans and saves for retirement, including an increased reliance on DC pension savings, pension dashboards and the so called 'pot for life model', are resulting in significant growth in the SIPP market which, according to the FT Advisor[18], is expected to reach £750 billion AUA by 2030. This is significant growth given that, in 2014, the SIPP market comprised 1.3m SIPPs[19] and was only valued at £200bn AUA.

As we move away from DB pensions, we are seeing extensive growth in all aspects of the DC market including trust-based DC schemes held by both employers and master-trusts as well as contract-based group personal pensions which are generally operated by insurers.

This change, coupled with a change in the way people work, has also seen a move away from employers taking the 'paternalistic' approach to supporting employees with pension savings that we saw in previous generations. The rise of the 'gig economy' and an increasing trend towards shorter term employment relationships has coincided with many employers providing the minimum pension arrangement to satisfy auto-enrolment requirements. In most cases, this will not be sufficient to fund employees' retirements and,

17 https://www.fca.org.uk/publication/discussion/dp24-3.pdf

18 https://www.ftadviser.com/pensions/2024/05/20/sipp-market-projected-to-grow-to-750bn-by-2030/

19 https://www.ftadviser.com/pensions/2024/02/05/two-thirds-of-sipps-are-non-advised-with-number-expected-to-grow/

increasingly, we are seeing individuals setting up their own pension saving vehicles with FCA or TPR authorised providers. In turn, this has led to considerable focus on the protection and support needed by pension savers. Unsurprisingly, a lot of the focus in this area is on those providers operating in the pension space.

This seismic shift in the way the UK population saves for retirement and makes decisions about how they access their pension has prompted a significant review by the FCA, DWP and the Pensions Regulator (TPR) of all aspects of the DC market.

Key areas being considered include:

- **Productive Finance** – an initiative designed to encourage greater investment in the UK economy by pension funds. We consider this below in the context of LTAFs.
- **Advice and Guidance**- the AGBR considers the way in which consumers can access appropriate and cost-effective support for making pension decisions.
- **Value for Money** – marking a shift away from a focus on asset management charges onto broader ways providers can deliver value for money to pension savers.
- **Dashboards** – this project is well underway and by October 2026, UK savers are expected to be able to access dashboard showing all of their pension savings in one place.
- **Consumer Duty –** in particular, during 2024, the FCA published a call for evidence on the simplification of their pension rules and guidance[20].
- **Pension Transfers** – in 2021, regulations introduced requirements on pension trustees and providers to consider the merit of member transfer requests and whether requests prompted any "red flags". During 2024, we have seen increasing commentary on:
  - The use of these requirements. Many providers are increasingly concerned about permitting transfers and, at the same time, some providers have been accused as using these requirements as a way of holding customers 'hostage' and preventing transfers.
  - Providers also finding themselves stuck with transfer out requests which cause real concern whilst not quite amounting to a red flag, meaning they have a statutory obligation to transfer. At times, this conflicts with the Consumer Duty, which a firm may consider would require it to block a transfer.

As the SIPP market grows so do the day-to-day challenges faced by operators, including managing distressed assets.

Whilst many of the developments in personal pensions are still in train, it seems clear that we have another year (indeed, likely many years) of regulatory scrutiny ahead - and that providers and trustees will need to give significant consideration to the evolving legal and regulatory landscape.

Liz Ramsaran

Partner, Pensions

E Liz.Ramsaran@dwf.law

M +44 (0)7483 399 693

Aaron Osborn

Director, Financial Services Regulatory

E Aaron.Osborn@dwf.law

M +44 (0)7892 701 766

20 DP24/3 Pensions: Adapting our requirements for a changing market

A discussion with the FCA: the future opportunities and risks arising from DC pensions

There are significant changes happening in the pension space – not all of them are necessarily compatible with each other. The FCA published a Discussion Paper (DP24/3[21]) at the end of the year to start a conversation around where further changes might be needed to better support consumers.

The Discussion Paper focuses on three areas where the FCA is proposing to review and update its existing framework:

a

Digital tools and modellers for existing pension savers

b

Defined contribution (DC) pension transfers and consolidation.

c

Self-Invested Personal Pensions (SIPPs)

The two overriding themes are providing additional support to consumers or alleviating and addressing harm in the DC pension market. This reflects the increased responsibility placed on consumers to manage their own retirement savings since the shift from defined benefit pensions to DC pensions, and the number and complexity of choices for consumers about how to use their DC pension savings through retirement. This is also in keeping with the Advice Guidance Boundary Review (AGBR), both specifically for pensions as well as for the wider retail investment market.

The call for responses to the Discussion Paper remains open until 27 February 2025

21 https://www.fca.org.uk/publications/discussion-papers/dp24-3-pensions-adapting-our-requirements-changing-market

Digital tools and modellers

The FCA shows a clear intention to 'move with the times' and embrace the development of the 'online consumer environment' as consumers incorporate digital technology into their financial lives.

There are obvious potential benefits of digital tools and modellers. High quality digital tools can help improve and support consumers' engagement with their pensions by allowing them to understand more easily their likely retirement needs and whether their current provisioning will meet them. This will help consumers to take action before it is too late.

The FCA recognises its rules can restrict firms from offering and developing effective tools and modellers. This is primarily down to the prescriptive requirements under COBS that are incompatible with digital modellers. However, the FCA also recognises that without the right regulatory framework in place, digital tools and modellers can cause significant consumer harms. Such harms can arise from over-optimistic assumptions and/or misleading projections, poorly designed or unsuitable tools and the failure to manage known customer biases.

The FCA offers a number of potential suggestions for a replacement regime but these would only apply to digital tools and modellers. The proposals revolve around trying to find a balance to allow digital projections where they help consumers; ensuring any regime is future proof by allowing sufficient flexibility and ensuring any flexibility does not result in firms causing consumers harm by not having to comply with minimum stated or fixed requirements.

Transfers and consolidation

Where individuals transfer and/or consolidate their DC pension(s), the FCA has identified two potential principal concerns:

1. whether consumers understand the full impact of transferring their pension(s); and
2. the operational efficiency in the transfer process and the existence of considerable delays.

Additionally, the FCA has identified wider issues including the risks arising from pension transfer scams and/or harms more generally arising from transfers. This includes whether consumers who ask to transfer do so on a well-informed basis.

Owing to the development of pension consolidation and pension tracing services, there is increasing consumer understanding about forgotten and un-accessed pensions. This, combined with changing employee habits such as the increasing number of jobs people have in their careers, is leading to an ever-increasing number of small DC pensions. The identification of such pots will increase when the Pension Dashboard is implemented. This makes pension consolidation even more relevant and important but also increases any risks inherent in the market and regulatory framework.

In addition, stakeholders have raised concerns that transfers may be happening for the wrong reason. This includes where the receiving scheme offers an incentive, perhaps leaving the client in a worse position longer term. There are also concerns that consumers are not considering or comparing schemes properly (or at all) and may be agreeing to transfers accidentally (such as when they intend to obtain information without realising they have signed up to a consolidation service).

The FCA wants to ensure consumers are only transferring when it is in their interests to do so. Whilst there are statutory transfer regulations and protections in place, along with the increased protections under the Consumer Duty, the FCA wants to understand further the risk and harms faced by non-advised consumers. It is considering whether its regulatory regime can help address any of these concerns, whether this is through: setting minimum expectations on both ceding and receiving schemes; the standardisation (in part) of client communications; and/or, consideration of the impact and appropriateness of incentives and the safeguards that firms put in place when making such offers.

Finally, the FCA is seeking views on the reasons for transfer delays as well as an understanding of when a delay represents appropriate friction as opposed to an unreasonable barrier.

SIPPs

The most significant component of the Discussion Paper relates to the SIPP market. The FCA explains that the SIPP market has changed significantly from when the products were first devised. Historically, SIPPs were aimed at more sophisticated and/or wealthy investors with esoteric investment options. Whilst this remains the case in some instances, SIPPs have become significantly more prevalent for the mass market. This type of SIPP product is generally much simpler and only invests in standard investments.

As is well known, some SIPP operators have historically operated with poor practices, allowing their clients to be targeted by scams or exposed to inappropriate investment outcomes. This has led to unsophisticated clients unwittingly losing significant sums. It is noteworthy that 15 SIPP operators have become insolvent since 2018 (with other SIPP operators having come close to failing and some are still at risk).

The concerns raised by the FCA include:

1. ensuring consumers end up in the 'right' SIPP product and whether different SIPP products require different support;
2. firms having deficient target market processes;
3. a continuing lack of adequate due diligence on introducers and investments on an initial and ongoing basis; and
4. whether SIPP operators have sufficient processes to ensure they properly safeguard and administer pension assets and money.

SIPP Segmentation:

The FCA segments the SIPP market into three types of SIPPs (Bespoke, Simple and Ready-made SIPPs). An interesting question posed is whether these categories of SIPPs are correct and whether consumers likely need different support based on the SIPP type. This leads to the possibility of diverging regulatory regimes depending upon the type of SIPP product.

Target Market Failings:

The FCA has identified continuing concerns with SIPP operators' target market analysis and processes. This means firms are at a greater risk of distributing SIPPs to the wrong clients, increasing the risk of harm to those clients. The FCA makes clear it will continue to use its Consumer Duty powers to address this. Whilst not mentioned in the DP, in our experience, if a firm does not have sufficiently granular target markets, there is a very real chance the firm's fair value assessment and consumer outcomes testing is likely to have deficiencies. This is because it likely uses the same or similar groups or cohorts.

Inadequate Due Diligence:

Whilst the FCA recognises due diligence processes have improved, it still has concerns in relation to initial and ongoing due diligence with "*many*" firms having "*insufficient procedures, systems and controls*". To help counter this, the FCA is seeking views on whether it should set out more detailed rules and guidance. We support this approach and struggle to understand why this has not already happened. That said, SIPP operators should engage with this part of the DP as there is a real risk of the FCA setting its requirements unreasonably high, particularly for simpler SIPPs or clients that are more sophisticated.

Safeguarding Money and Assets:

The final component the Discussion Paper addresses the robustness of processes in place to safeguard pension scheme money and assets. The FCA recognises that the use of unregulated trustees can result in trust assets being held by unregulated firms, resulting in significant variation in the rules and requirements that apply to the entities safeguarding pension money and assets. The FCA believes this is partly to blame for inadequate systems and controls implemented by some firms and, therefore, poses risks to consumers. We have unfortunately seen this multiple times.

The FCA sets out a number of its concerns. These relate to various areas including record keeping, reconciliation deficiencies, client reporting, and insufficient external assurance. For example, the FCA specifically identified that SIPP operators do not reconcile trustee bank accounts in a timely manner and/or rely on external banking records to update their internal records and perform reconciliations. The FCA also identified concerns with the approach and frequency in valuing custody assets. It is noticeable that these concerns are addressed in the CASS rules, which do not apply to SIPP operators' who structure their business to incorporate an unregulated trustee (but do apply where the trustee is also regulated).

We have always advised SIPP operators to use CASS as a guide for their approach to safeguarding. Whilst the FCA asks firms for their opinions, it says it considers a more prescriptive approach should be applied to ensure a common standard of regulatory protections. In short, we expect any guidance or requirements to be based on, at least loosely, some of the requirements set out in CASS but (hopefully) adapted to take into account the nuances in trust law and the fiduciary duties with which trustees are required to comply. To this end, we encourage SIPP operators to engage with the Discussion Paper to highlight any challenges they would face with overly prescriptive safeguarding rules (and explain why). Firms could consider the CASS rules and identify sections within them that would not be appropriate for SIPPs.

Conclusion

The FCA is evidently focusing on areas where firms can either provide additional support to consumers or alleviate and address harm that is happening in the market. It is important that market participants feedback to try to limit the risk of well-meaning but poorly targeted reforms. This appears a genuine attempt by the FCA to reach out to the market and ask for its input.

This (apparently) cooperative approach may be indicative of how the FCA is going to try and balance its goal of empowering consumers and reducing harms whilst supporting innovation and complying with its secondary objective to support competitiveness and promote growth in the UK economy.

Aaron Osborn

Director, Financial Services Regulatory

E Aaron.Osborn@dwf.law

M +44 (0)7892 701 766

James Ram

Associate, Financial Services Regulatory

E James.Ram@dwf.law

Rethinking Retirement Income: From Accumulation to Decumulation

What is the Thematic Review on Retirement Income Advice?

The FCA's Thematic Review on Retirement Income Advice represents a pivotal examination of how firms are adapting their advice models to meet the needs of consumers transitioning from pension accumulation to decumulation.

The stakes are high. Pension freedoms, introduced in 2015, gave savers more flexibility in how they use their pensions. Yet, this freedom brings complexity and risk. Savers must now decide how much to withdraw, how to invest, and how to ensure their money lasts. Poor advice can have serious consequences, leaving people with insufficient income or incurring unnecessary fees.

Conducted in 2022–2023, the review assessed the practices of 977 firms and involved an in-depth analysis of 24 firms' retirement advice models. Its primary goal was to evaluate the suitability and consistency of advice provided to retirees in light of evolving market conditions and regulatory standards, including the introduction of the Consumer Duty in July 2023.

A Changing Retirement Landscape

The retirement market is expanding rapidly, with the Defined Benefit (DB) market valued at £2.17 trillion and the Defined Contribution (DC) market worth £1.41 trillion. DB pensions, once the standard for many workers, are now being overtaken by DC schemes, where savers bear greater responsibility for managing their money.

With the introduction of auto-enrolment, 79% of UK employees are now saving into workplace pensions. As more individuals rely on DC pensions, they face complex decisions about income sustainability, investment risks, and tax implications. The review noted a growing trend of retirees moving away from guaranteed annuities—chosen by only 10% of pension holders in 2021/22—and towards drawdown solutions, often without proper advice.

Big financial decisions can be daunting, and decumulation advice is becoming increasingly critical given the widespread prevalence of modest pension pots at retirement. Most retirees have less than £200,000 saved—a figure that could struggle to stretch across decades of retirement, raising significant concerns about access to affordable, tailored financial advice.

The Thematic Review underscores the risks faced by these consumers, particularly in understanding the trade-offs between sustainable income, investment risks, and the potential depletion of funds. Firms' failure consistently to address these challenges has resulted in unsuitable advice in 11% of reviewed cases and material information gaps (MIGs) in 22%.

Opinion: Will the Recommendations Go Far Enough?

The FCA's findings reveal systemic shortcomings. Cashflow modelling—an essential tool for showing how long savings might last—is not used consistently. Some advisers also fail to reassess a client's risk tolerance or explain how much income can be withdrawn sustainably. These gaps increase the risk of savers making poor choices.

While the introduction of the Consumer Duty sets a higher bar for consumer protection, the review suggests that existing measures may still fall short in safeguarding vulnerable consumers. For instance, firms often failed to cater adequately to consumers with smaller pension pots, reflecting a potential mismatch between advice services and the needs of the majority. Moreover, biases based on gender, race, or other demographic factors remain underexplored, raising questions about inclusivity in the advice market.

There is also ongoing concern within the industry as to whether advice firms—especially smaller ones—have the resources to meet these higher standards.

Practical Implementation: Challenges and Opportunities

From a provider and adviser perspective, implementing the review's recommendations poses significant challenges. Many firms struggle with inadequate systems for tracking advice quality and customer outcomes. Smaller IFAs face resource constraints, complicating their ability to adopt robust cashflow modelling tools or provide consistent ongoing reviews.

However, there are opportunities for improvement. Our work with financial advisers shows that better training, clearer advice processes, and stronger oversight can make a real difference. Ensuring advice is tailored, clear, and accessible will be key to helping savers make better decisions.

The Role of Fintech and Tailored Guidance

Fintech innovation has the potential to revolutionise decumulation advice, offering cost-effective, personalised guidance. Automated systems and tools can assess risk, calculate sustainable income levels, and deliver clear guidance. However, these tools must be carefully designed to avoid biases that could disadvantage groups such as women, ethnic minorities, or LGBTQ+ consumers. The AGBR proposals for targeted support for pensions[22] specifically is a welcome development. Focusing first on pensions will enable the development of valuable guided services to direct clients to a sensible course of action (whereas the wider proposals for investment distribution will face the greater challenge of steering investors towards the 'right' product choices without giving regulated advice).

What's Next?

The Thematic Review is a wake-up call for the retirement market as a whole. It shows there is significant room for improvement, particularly in how firms support those with smaller pots or complex needs. While the Consumer Duty and other FCA rules are a step forward, real change will depend on how well the industry responds. The FCA 'went easy' with last year's report and firms giving 'at' and 'in retirement' advice should not expect an easy ride next time.

Matt Baggott
Consultant, Regulatory Consulting
E Matthew.Baggott@dwf.law
M +44 (0)7517 499 081

Liz Ramsaran
Partner, Pensions
E Liz.Ramsaran@dwf.law
M +44 (0)7483 399 693

22 https://www.fca.org.uk/publications/consultation-papers/cp24-27-advice-guidance-boundary-review-targeted-support-reforms-pensions

SIPPs and distressed assets

The SIPP market is growing rapidly. Whilst much of the growth in the SIPP market is expected to be in relatively straightforward assets, there are already a significant proportion of distressed assets held in SIPPs. Such assets can cause significant challenges for providers and SIPP customers. This article explores key issues we are seeing when supporting our clients with distressed assets in their SIPP books and some practical considerations in dealing with these issues.

Why are there distressed assets in SIPPs?

SIPP operators and trustees are (usually) unlikely knowingly to accept distressed assets at the point of investment. Assets can be volatile and change in their nature while in a SIPP portfolio. From a SIPP trustee perspective, subject to the structure of the SIPP, they are likely to have a fiduciary duty to ensure investments are appropriate. The recent Pensions Ombudsman determinations in respect of the Rowanmoor SSAS book highlight this obligation. Whilst SIPPs and SSASs are different in nature, some of the reasoning leading to the Ombudsman's determination against the trustees could easily be applied to certain SIPP trustees.

In any event, SIPP operators are FCA regulated and are therefore required to have systems and controls in place which ensure only appropriate investments are accepted into the pension scheme (and there are due diligence obligations on SIPP operators). The Consumer Duty introduced in July 2023 goes further and requires firms to act to deliver good outcomes for retail customers. This includes putting in place robust systems and controls to prevent customer harm and ensure financial resilience. This will increase ongoing monitoring obligations and requirements for client communication and support.

Despite an increasingly robust legal and regulatory framework looking to ensure SIPP assets are appropriate and not unduly risky (at least for mass market pension members), there are a variety of circumstances leading to individuals holding distressed assets. These include economic downturns, poor investment returns and insolvency events in relation to underlying assets and, of course, scams and fraud. Many providers have also inherited distressed assets as part of the acquisition of a SIPP book from another provider and have not been able to dispose of those assets as part of the transaction, a point we consider further below.

The FCA's discussion paper, Pensions: Adapting our Requirements for a Changing Market published in December 2024 (covered elsewhere), considers options around setting-out clearer, more detailed due diligence obligations in the Handbook rules.

In our view, the increased focus on diligence is a positive step towards helping protect members from poor investments. Firms would also welcome clarity on due diligence requirements and expectations as there is material uncertainty at the moment. In practice this results in an increasing number of providers narrowing the pool of assets they will administer. This arguably dilutes some of the appeal of SIPPs, which are traditionally seen as more versatile than other defined contribution arrangements.

Why is this an issue?

The first clear issue is that a distressed asset is unlikely to yield investment returns and, in turn, contribute to a member's retirement income in the way that they had originally planned when making the investment. However, the issues arising out of distressed assets can be much more far reaching than that.

Liabilities

Some assets may actually attract liabilities on the owners who will generally be a mixture of the pension trustees and members who (as a starting position) will have joint and several liability in respect of the assets.

A clear example of this is property, which may attract ground rent or liabilities associated with tenants such as business rates. The legal owners of the property (often the SIPP trustee and members) may also be exposed to occupier's liability risks, particularly if properties are poorly maintained.

Whilst many providers have an indemnity in the scheme rules in respect of such liabilities, those indemnities are only worth the value of the assets in the scheme, which may not be sufficient to cover liabilities.

Many providers also lack a clear agreement with members regarding responsibilities around managing, maintaining and even insuring property. This can result in challenges, particularly in the event of third-party claims made in respect of properties.

Prevent transfers

Where a member is in drawdown, the law does not permit a partial transfer from one fund to another. Such a transfer would be an unauthorised payment and therefore attract HMRC sanctions on both the member and transferring provider.

We are also seeing a number of providers refuse to allow partial transfers out of their schemes on the basis that they do not want to be left with distressed assets. In some cases, this is being driven by the traffic light system introduced by the Pension Transfer Regulations in 2021. For example, some providers would categorise a transfer as a 'red flag' if, by carrying out a partial transfer, the member will end up paying higher overall fees as they will have assets in two separate SIPPs.

Providers are increasingly selective about the assets they will accept and so in practice we see many members 'stranded' with their SIPP provider as they are unable to complete a partial transfer of their assets. This can cause a significant amount of distress for members and also result in them paying higher charges than they may be required to pay compared to other providers. We can see why firms take this approach. It will be interesting to see if the FCA considers whether this is compliant with the Consumer Duty, for example.

One work-around we have seen members who have reached their minimum pension age (usually age 55) use is to simply draw down their non-distressed assets, leaving their distressed assets in the fund.

Costs and charges

From a provider perspective, distressed assets may require more work to hold than other, simpler assets and therefore prove administratively challenging.

The concerns with members drawing down or transferring out all of their non-distressed assets and simply leaving distressed assets are: (i) the ability to recover fees; (ii) the ability to draw on any indemnities or other protections in respect of potential liabilities associated with those assets; and, (iii) a lack of member engagement.

Additionally, distressed assets will (almost certainly) be non-standard assets for the purposes of calculating required regulatory capital. This could require SIPP operators to hold significantly more capital.

We are aware that many providers have hundreds if not thousands of schemes in this position.

What can members do?

This is a significant issue for many SIPP providers, and we are aware that many are looking at ways to support their members in recovering losses associated with, and subsequently removing, distressed assets from their SIPPs.

Compensation

Depending on the cause of the distress, members may be eligible for compensation from the FSCS. Where a member applies for FSCS compensation, they complete an application form under which they essentially agree to assign any third-party rights in respect of the assets in question to the FSCS.

Where the FSCS pays such compensation, it may then ask the Trustee of the relevant scheme in turn to grant them an assignment in respect of the assets. Importantly, the FSCS does not take ownership of the assets, which remain in the scheme.

Whilst the FSCS assignment process works in many situations, there are some potential flaws with their approach from a provider perspective. For example, where the FSCS take an assignment of the asset, scheme trustees are then limited in their ability to do anything further with the asset, meaning they essentially have to hold the assets, potentially attracting associated liabilities (and operational cost) until such time as the FSCS agree that they can be released. In these circumstances, where members have been compensated, it is often difficult to get member engagement. Further, where SIPPs are left holding just a distressed, compensated asset it is challenging to recover costs and trustees are exposed to potential liabilities. Where SIPP providers are asked to provide FSCS assignments, it is important to engage with the FSCS in respect of their proposed approach to dealing with said assets and to maintain open dialogue with them so as to mitigate risks associated with holding such assets.

Write off the asset or gift it to charity?

This would instinctively seem like an ideal solution (subject to the FSCS assignment point above). However, outside of an insolvency process, it is not generally possible to simply write-off an asset. Further, the pension payment rules do not permit gifting an asset to charity. As such, any attempt to distribute the assets in this way may be considered by HMRC to be an unauthorised payment.

Members buy assets out of the SIPP

The sale of an asset to a member or one of their family members would be a 'connected party transaction'. In order to complete such a transaction, the sale would need to be at market value, supported by a valuation.

It will be important to demonstrate the governance around this as HMRC are likely to look closely at such transactions on the basis that this approach could be used as a form of pension liberation. From a practical perspective, depending on the asset, it may be disproportionately costly to obtain the valuation required to support the sale.

Exercise a lien over the asset

As a general principle of trust law, trustees are able to access a lien over scheme assets in order to cover unpaid costs. In some cases, it may be appropriate for trustees to use these powers to take ownership of assets removing them from member SIPPs. However, this will largely depend on the structure of the trust and the specific powers and limitations on the trustee of a particular SIPP.

Providers would need to consider the appropriateness of this option on a case-by-case basis. However, where the power is exercised, they would have more options for dealing with the assets and potentially closing legacy SIPPs.

Key considerations for providers

The protections and options available for SIPP providers will often turn on the terms governing their SIPPs and other agreements in place with their members. We are aware that many providers do not have sufficient clarity over roles, responsibilities and options in respect of distressed assets in these documents. Additionally, with the requirements of the Consumer Duty, providers need also to work through additional regulatory considerations. Put simply, the issues that we are seeing in practice were not historically considered by draftsmen. We have recently supported providers in reviewing and rationalising property and associated insurance documents to address these increasingly common issues.

Where providers consider that they have a significant number of cases with distressed assets, it is worth engaging with the FSCS and HMRC constructively and early on in order to agree the best course of action.

Liz Ramsaran

Partner, Pensions

E Liz.Ramsaran@dwf.law

M +44 (0)7483 399 693

LTAFs: A 'fund'-amental shift in wealth management?

The Long-Term Asset Funds (LTAFs) market has seen significant growth since their introduction in November 2021. LTAFs are a relatively new category of UK-authorised open-ended fund vehicles, designed to facilitate investment in long-term, less liquid assets, making them accessible to a broader range of investors, including pension funds and retail investors.

The introduction of LTAFs has opened up a wider range of assets available to long-term investors, including private market investments, which have traditionally been available only to a minority of investors. These assets can include infrastructure projects, renewable energy, fintech, life sciences, and artificial intelligence. The introduction of LTAFs has received bi-partisan political support as a means to foster long-term economic growth in the UK by driving more capital into unlisted UK companies and infrastructure projects.

Uptake for investing in LTAFs has been relatively slow, with only the UK's largest funds showing a keen interest at this point. This is likely to be as a result of the cost and complexity associated with investing in, monitoring and divesting from less liquid assets. It is likely to be necessary for the larger schemes to 'blaze the trail' in order for trustees to get comfortable with investing in less liquid assets.

As the DC market grows and trustees are encouraged to focus more on long-term value for money than short-term management fees, we anticipate that appetite for investing in LTAFs will increase across the DC pension market.

Historically, pension scheme trustees have focused on investing in liquid assets. This has been driven by a number of factors, including a focus on minimising annual management charges. The focus on liquidity also exposes investors to paying a 'liquidity premium' as well as, at least in the case of non-US markets, often sluggish investment returns.

The UK Government has been supporting greater investment in private market assets for some time, with early support given in November 2020 when the then Chancellor, Sajid Javid, committed to the launch of LTAFs. This initiative is primarily intended to broaden investment options for UK defined contribution (DC) pension funds. Having exposure to such investments is seen as particularly beneficial for pensions savers as the longer time horizon aligns with the often only long-term returns offered by investments in sectors such as real estate and infrastructure, as well as their reduced need for liquidity in the nearer term compared with other managed investments.

In 2023 and early 2024, the then Chancellor, Jeremy Hunt made a series of statements and policies aimed at encouraging DC pension trustees to invest in the UK economy - this has become known as the "Productive Finance" initiative. During her 2024 Mansion House speech and as part of the recent government budget, the current Chancellor, Rachel Reeves, has continued the Productive Finance initiative by launching a consultation on consolidating DC pension schemes by introducing minimum size requirements for auto-enrolment schemes, and setting an upper limit on the number of such schemes. This is intended to result in the creation of larger pension schemes that are more able to invest in private markets.

This approach is consistent with other jurisdictions including Canada and Australia where their superfunds have been successfully investing in less-liquid assets (including in the UK) for years. Many advocates for this initiative point to the successes of these funds as a template for the UK pensions market to follow.

The use of LTAFs to provide exposure to private market investments is proposed as a way to improve pensioner saver outcomes by allowing access to alternative investments, as well as ensuring pension trustees (and other investors) are able to gain from opportunities which enhance growth in the UK.

Market Reaction

Trustees of the UK's largest DC pension schemes have responded positively to the introduction of LTAFs and opening up of private markets opportunities. Some of these trustees have announced that they will allocate at least 5% to private markets under their default asset allocation, with many commentators expecting to see allocations of 20% or higher.

There has been a slower uptake generally across trustees of the medium to smaller funds. This is not surprising as for these funds they will need to consider more carefully the need for diversification and liquidity as well as the cost of executing, monitoring and reporting on investments of this nature. As LTAFs are still relatively new, pension trustees will incur meaningful time and fees in considering investing in such structures.

Where trustees are investing in LTAFs they will have exposure to a greater range of investments such as real estate, venture capital and private credit. In turn, they will arguably benefit from greater diversification and reduced risk by having exposure to investments other than in public markets. Furthermore, trustees which hold private investments are often able to exercise more direct control or influence over the relevant assets which may be developed or improved over time, allowing for enhanced outcomes.

How LTAFs can address historic barriers to investing in less liquid assets

Historically, trustees have faced operational challenges when seeking to invest in less-liquid assets. These include challenges in terms of fee and charges caps as well as technology and reporting. For example, trustees have had challenges accommodating private assets on platforms, as well as resolving issues such as stale valuations, which may impact their fiduciary and regulatory duties in respect of treating members fairly.

We have outlined below some key barriers to investing in less-liquid assets and how the LTAF framework looks to address these.

Stale valuations

Stale valuations arise as a result of pension fund portfolios being priced daily. By including a private market component, which is valued less frequently, a risk is created that the portfolio may be mis-priced in the interim. As a result, members who transfer in or out of a pension fund may be paying too much, or receiving too little in respect of their holdings.

LTAFs are required to employ advanced valuation methodologies to ensure that the value of private market assets is accurately reflected in the portfolio. Additionally, the FCA requires that LTAF assets are valued at least monthly as well as each time investors are allowed to deal in its units. This helps mitigate the risk of mispricing and ensures that investors transferring in or out of the portfolio are treated fairly. By providing more frequent and accurate valuations than generally seen with less-liquid assets, LTAFs help maintain the integrity of the pension fund's pricing and protect the interests of all members.

Fees and charges

Historically, there have been very low fee and charge caps on pension funds used for auto-enrolment, making investment in less liquid assets very challenging. These requirements have recently been relaxed, however there is still a continuous need for trustees to monitor and demonstrate value for money to members. Private market investments often involve the payment of performance fees creating a further risk in respect of treating members fairly.

As performance fees are paid on a periodic basis, such as on the sale of an asset or at the end of a term, trustees need to consider how to distribute such fees across members in an equitable way. This is not always straight forward.

LTAFs also address the challenge of performance fees by implementing fair and transparent fee structures. This approach, combined with the implementation of policies to ensure members are treated fairly, will allow scheme trustees to prevent members who hold the investment at the time of the fee but after the performance from being charged unfairly.

Liquidity

Although pension schemes have some of the longest time horizons in the investment industry, scheme trustees still face liquidity requirements, for example in order to facilitate payment of pensions and death benefits and members leaving, as well as rebalancing or the payment of fees. Indeed, some pension providers have raised that these liquidity requirements may increase in the future if the UK follows other jurisdictions in incentivising contributions by allowing members greater access to capital. Including private market assets in pension portfolios may result in the liquidity required for these operations being more difficult to achieve.

LTAFs offer solutions to meet the liquidity requirements of pension schemes, enabling a balance between allowing exposure to long-term investments and the need for liquidity. As LTAF units are typically redeemable on 90 days' notice, they provide relatively high liquidity even where the underlying assets may not be equally realisable. Additionally, pension scheme trustees are able to implement liquidity management plans before allocating to private investments to ensure withdrawal demands can be met through the use of a mix of liquid and less-liquid assets. This flexibility allows trustees to meet liquidity needs while still benefiting from the higher returns and diversification offered by private market assets.

Operational challenges

Many medium to smaller sized DC schemes lacks the infrastructure to hold assets which aren't cash or on a platform. Investing in less liquid assets can therefore be operationally challenging and attract disproportionate costs.

Further, governance and reporting obligations on trustees have been steadily increasing over recent years and trustees now have an obligation to monitor and demonstrate value for money to members. These obligations are harder to satisfy where assets are held outside of trustees' existing platforms.

The use of LTAFs as a vehicle to invest in private markets assets goes some way to address these operational challenges. LTAFs may be more easily accommodated on platforms, allowing for some of the technology and reporting issues to be resolved. This is achieved by LTAFs providing a structured framework that allows for the integration of private market investments into existing pension schemes, ensuring that these assets are managed and reported in a consistent and transparent manner.

LTAFs should also be supported by robust governance frameworks that enhance the oversight and management of private market investments. These frameworks include regular monitoring and reporting requirements. By ensuring that private market investments are subject to such enhanced governance requirements, pension scheme managers are more easily able to navigate the complexities of these assets and maintain compliance with the required regulatory standards as a result.

Future Trends

Although there has been initial hesitation from some trustees to allocate to private market investments, the adoption of LTAFs is becoming increasingly popular. As a result, there are a growing number of LTAFs being launched, with 24 already in existence and more in the pipeline. This indicates a strong upward trend in their adoption.

The Productive Finance initiative and the consolidation of DC pension schemes are likely to play a significant role in the increasing take up of LTAFs by pension scheme trustees. Larger DC schemes will be more able to balance the risks presented by exposure to private market investments by being able to invest in larger projects, such as in real estate or infrastructure, without requiring the commitment of a significant portion of the assets under management. Similarly, there is a strong argument that consolidated, larger schemes will be more easily able to manage liquidity within their portfolios in the same manner.

Furthermore, the way in which many LTAFs are being marketed indicates that, as well as focusing on off-market opportunities, such as real estate and private credit, private market investment may be used to more effectively meet investment restrictions commonly in place for pension schemes. For example, many LTAFs are geared to invest in diversified or multi-sector private assets, reducing concentration risk that might otherwise be associated with exposure to less liquid long-term investments. LTAFs may also assist with meeting pension scheme objectives such as in respect of ESG considerations by focusing on areas such as 'climate transition', societal impact and renewable energy.

Consequently, notwithstanding the challenges posed by pooling investors in larger funds and incorporating private market investment, the momentum behind these developments and the benefits of doing so as outlined is likely to result in the continued uptake of LTAFs in the pensions and wider investment industry.

Ravi Longia
Partner, Head of Funds (UK)
E Ravi.Longia@dwf.law
M +44 (0)7518 200 278

Simon Lewin
Solicitor, Investment Funds & Financial Services Regulatory
E Simon.Lewin@dwf.law
M +44 (0)7926 697 722

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Robbie Constance

Partner, Head of Wealth Management Regulatory

E Robbie.Constance@dwf.law

M +44 7545 100 514

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