LATHAM & WATKINS

9 November 2022

Financial Regulation Monthly Breakfast Seminar

Overview

- FCA's latest consumer investments strategy, and vulnerability analysis
- FCA's consultation paper on its Sustainability Disclosure Requirements (SDR) and investment labels regime
- PRA / FCA / Commission views on the changing regulatory landscape

FCA's latest consumer investments strategy, and vulnerability analysis

Becky Critchley

FCA Consumer Investments Strategy – 1 year update

- FCA maintained its focus on preventing and reducing serious harm to consumers in this market. For example, the FCA:
  - Stopped 1 in 5 new consumer investment firms who applied from entering the market
  - Opened 59% more supervisory cases on high-risk investments or investments scams
  - Published 1844 consumer alerts about unauthorised firms or individuals (a 40% increase)
  - secured £34.8m in consumer redress for unauthorised investment business
- Consumer-facing work shows the challenges ordinary investors face, particular increase in contact in relation to scams and potential scams

FCA Consumer Investments Strategy – 1 year update

- Future work:
  - Consulting on a more proportionate advice regime for investing money into stocks and shares ISAs
  - Carrying out a review of the advice/guidance framework
  - Investigating changes to prudential requirements for non-MiFID adviser firms to better enable them to meet their redress liabilities
  - Publishing a feedback statement on its review of the compensation regime
  - Continuing to review its consumer investments strategy in light of the current climate

FCA Consumer Investments Strategy – 1 year update

- FCA progress against the four targets for the consumer investments strategy to achieve:
    - Three of the four outcomes have declined
    - Scams and fraud at risk of failing
    - FCA "would not necessarily expect to see improvements in these long-term outcomes in the first year of the Strategy"

Financial Lives 2022 survey - insights on vulnerability and financial resilience

- Recap: 4 key drivers of vulnerability:
  - Health – health conditions or illnesses that affect ability to carry out day-to-day tasks
  - Life events – life events such as bereavement, job loss or relationship breakdown
  - Resilience – low ability to withstand financial or emotional shocks
  - Capability – low knowledge of financial matters or low confidence in managing money (financial capability). Low capability in other relevant areas such as literacy, or digital skills

FCA Financial Lives 2022 survey

- Full report due early 2023
- Selected statistics published to “*give an insight into the financial positions of UK consumers*” in May of this year
- Note: seven firms where FCA has engaged with them to change the way they treat customers have voluntarily agreed to pay £12 million in compensation to nearly 60,000 customers

FCA Financial Lives 2022 survey

- The number of vulnerable consumers or those with low financial resilience have risen since 2020
- 24% of all UK adults now have low financial resilience $\xrightarrow{\text{increase}}$ more than 2 million since 2020
- 7.8 million people are finding it a heavy burden to keep up with their bills $\xrightarrow{\text{increase}}$ from 5.3 million in 2020
- 4.2 million people in financial difficulty $\xrightarrow{\text{increase}}$ from 3.8 million in 2020
- Geographical differences exist. Those living in the most deprived areas of the UK are nearly seven times as likely to be in financial difficulty compared to those living in the least deprived areas

FCA Financial Lives 2022 survey

- Stark differences across different demographic groups exist:

Table 1: Socio-demographic groups of consumers more likely to have low financial resilience or be in financial difficulty

Factors	**Low financial resilience** **UK average: 24%**	**In financial difficulty** **UK average: 8%**
Sex	Female: 28%	Female: 9%
Age	18-54: 29%	25-44: 12%
Employment status	Unemployed: 48% Gig economy: 37%	Unemployed: 25% Gig economy: 16%
Household income	<£15,000: 50%	<£15,000: 20%
Household tenure	Rent: 47%	Rent: 19%
Ethnicity	Black and Black British: 44% Mixed/ multiple: 39%	Black and Black British: 16% Mixed/ multiple: 13%
IMD (Index of Multiple Deprivation)	Most deprived areas of the UK (ie IMD Decile 1): 42%	Most deprived areas of the UK (ie IMD Decile 1): 20%

Source: Financial Lives 2022 survey

FCA Financial Lives 2022 survey

- What can firms do?
  - Consider whether current data identifies potential vulnerability in these categories
  - Factor data into vulnerability framework
  - Training
  - Encourage early engagement
  - Tailored support, particularly for those with vulnerable characteristics
  - Signpost to free, independent debt advice
  - Ensure fees and charges are fair and only reflect the reasonable costs that firms incur
  - Consider whether it is appropriate to reduce, waive or cancel fees and charges
  - MI
  - Eye on Consumer Duty

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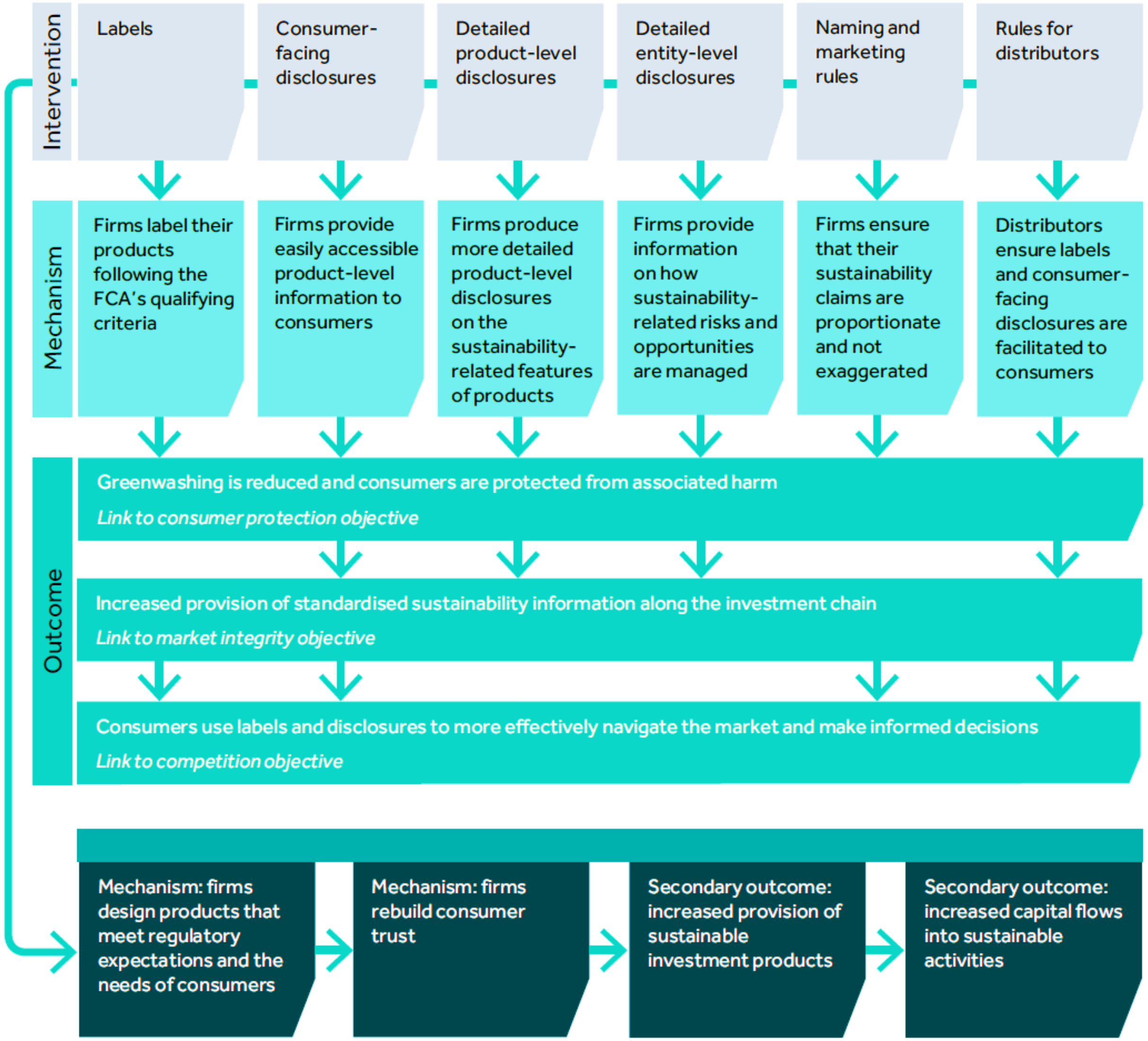
FCA's consultation paper on its Sustainability Disclosure Requirements (SDR) and investment labels regime

Anne Mainwaring

FCA CP22/20: Sustainability Disclosure Requirements (SDR) and investment labels regime

- *"Already today, greenwashing may be eroding trust in the market for sustainable investment products. Trust and integrity in these products are important to the transition to a more sustainable future. So, we need to build guardrails against this to protect consumers from potential harms. If consumers can't trust the claims firms make about their products, they will shy away from this market, slowing the flow of much-needed capital to investments that can genuinely drive positive change"*
- Core aim is for the UK to be a trusted centre for sustainable investment and place the UK at the forefront of sustainable investment internationally. The proposals aim to do this by setting robust regulatory standards to protect consumers that raise the bar and build a strong foundation for sustainable investment products

Overview of the FCA’s proposals



Scope

- Proposing general ‘anti-greenwashing’ rule: all regulated firms
- The core elements of the regime (labelling and classification, disclosure and naming and marketing rules) will apply to asset managers initially
- Retail vs institutional
- Further consultations will follow in due course on expanding the regime to FCA-regulated asset owners in respect of their investment products and overseas funds
- Proposed targeted rules for the distributors of investment products to retail investors in the UK

Sustainable investment labels

The Consultation Paper proposes to introduce sustainable investment product labels, divided into three categories:

1. Sustainable Focus: Investments in assets that are environmentally and/or socially sustainable. To qualify for this label, at least 70% of the product's assets either meet a credible standard of environmental and/ or social sustainability; or align with a specified environmental and/or social sustainability theme
    - Invests mainly in assets that are sustainable for people and/or planet

Sustainable investment labels

2. Sustainable Improvers: Investments to improve the environmental and/or social sustainability of assets over time, including in response to the stewardship influence of the firm
   - Invests in assets that may not be sustainable now, with an aim to improve their sustainability for people and/or planet over time

3. Sustainable Impact: Investments in solutions to environmental or social problems, to achieve positive, real-world impact
   - Invests in solutions to problems affecting people or the planet to achieve real-world impact

Sustainable investment labels

- The FCA emphasises that there is no hierarchy between the proposed categories: each type of product is designed to deliver a different profile of assets, and to meet different consumer preferences
- Each label will be underpinned by a set of clear, objective criteria that are intended to set a high bar for quality and integrity

Qualifying criteria

- In addition to the specific criteria for each label, the FCA has also proposed a set of threshold criteria that all firms must meet before they can use one of the sustainable investment product labels.
- The qualifying criteria are made up of five overarching principles covering:
  1. Sustainability objective
  2. Investment policy and strategy
  3. KPIs
  4. Resources and governance
  5. Investor stewardship

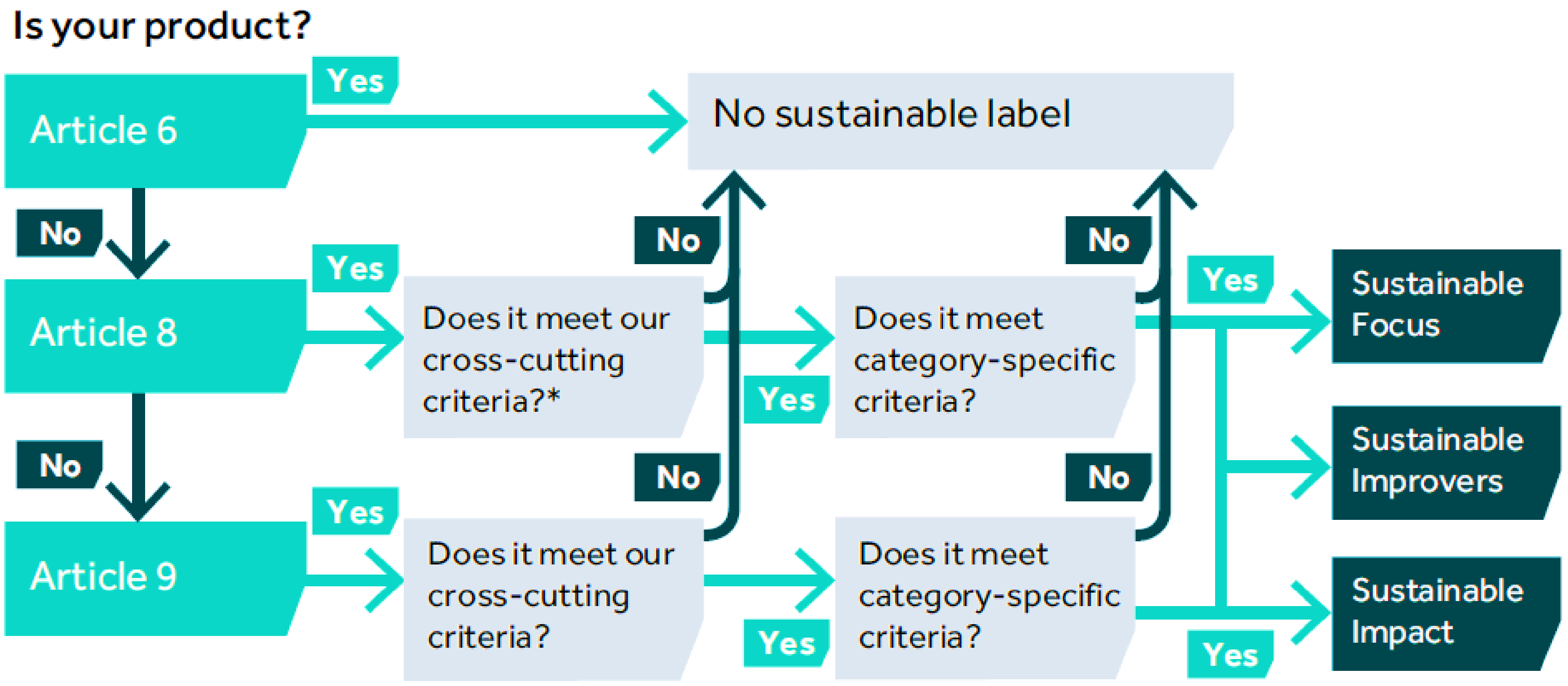
Qualifying criteria

- Labels can be used for products marketed to retail investors, and for those marketed to institutional investors, if the firm chooses to do so and meets the qualifying criteria. If not, firms marketing to retail investors must meet the naming and marketing rules
- Note there are proposed notification requirements to the FCA if a sustainable investment label is to be used

Interaction with SFDR

- “We recognise that the firms we regulate operate in global markets and are already subject to the EU SFDR, and will in future be subject to ESG disclosure rules proposed by the SEC. So, we are working to maintain coherence between our proposals…however…”
- “Our policy rationale for categorising products is to help consumers identify sustainable investment products and navigate the market. So, our criteria are designed to set a high bar for products that make sustainability claims, which is important to help clamp down on greenwashing against a backdrop of trust concerns. The starting point in the EU and US regimes, by contrast, has been to categorise products principally to determine disclosure requirements”

Interaction with SFDR

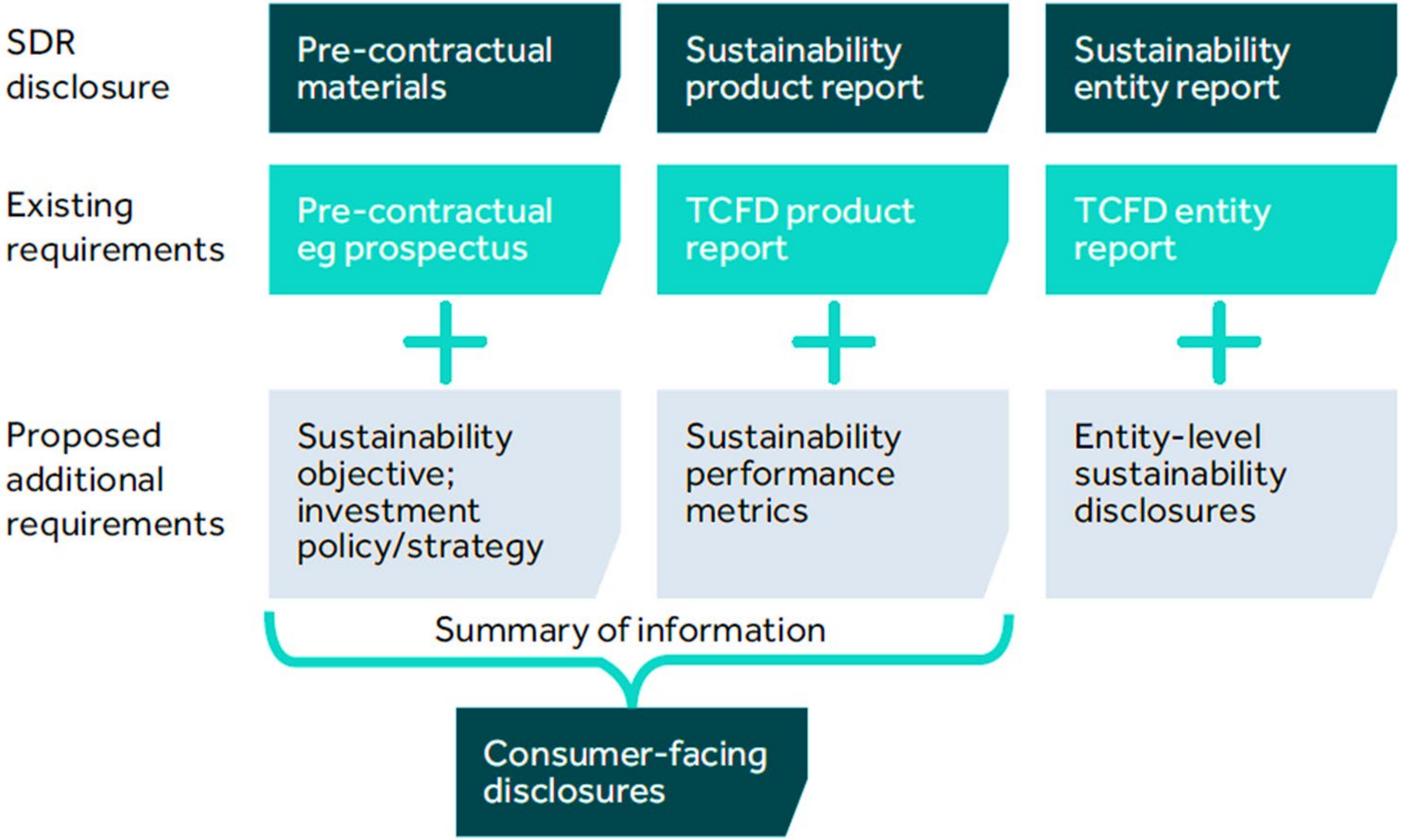


* Note that Article 8 funds will need to 'level up' to meet our criteria by specifying a sustainability objective. It is unlikely that an Article 8 fund would meet the criteria for Sustainable Impact.

Disclosure requirements

- The Consultation Paper also proposes the introduction of mandatory disclosure requirements, both in relation to (i) consumer-facing product level disclosures, and (ii) more detailed product and entity-level disclosures for institutional investors and consumers

Disclosure requirements



Consumer facing disclosures

- The proposed consumer-facing disclosures aim to complement the sustainable investment labels by providing retail consumers with clear, targeted information to help them make considered choices about their investments
- The proposals aim to ensure that consumers have sufficient information, presented in an accessible way, on the sustainability-related features of investment products to assess whether they meet their needs and preferences

Consumer facing disclosures

- The disclosure must be made available in a prominent place on the relevant digital medium for the firm (i.e. the main product webpage, page on a mobile application etc.). For products that qualify for a label, the consumer-facing disclosure should be no more than ‘one mouse click away’ from where the label is presented
- All in-scope firms must produce a consumer-facing disclosure for all in-scope products. For products that are not engaged in any sustainability-related strategies, the disclosure will be inherently more limited. However, the label field must be marked with ‘no sustainable label’ and other fields marked with ‘not applicable’ or ‘N/A’

Consumer facing disclosures

- FCA are proposing that firms must make the categories of disclosures as set out below:
  - **Basic information**: Include the firm's name, product name, International Securities Identification Number (ISIN), or any other unique identifier, and date
  - **Product Label**: Display this prominently towards the beginning of the disclosure and include a brief description of what the label means, consistent with the consumer-facing descriptors
  - **Sustainability goal**: Clearly state the product's sustainability objective, signposted as 'sustainability goal', highlighting if there is an impact or expected impact on the financial return e.g. expected implications for the financial risk profile. In addition, describe progress towards the sustainability objective, e.g. examples of actions taken, and interim goals achieved

Consumer facing disclosures

- **Sustainability approach**: Provide a summary of key elements of the product’s investment strategy to pursue the objective (e.g. investible universe, screening, themes), clearly signposted as ‘sustainability approach’. This should include, as appropriate, key sustainability characteristics of assets in which the product will and will not invest and the firm’s approach to stewardship. Our qualitative consumer research suggests that consumers may find it difficult to access terminology often used in the industry (e.g. ‘best in class’ and ‘stewardship’). Firms must use language that will be familiar and comprehensible to consumers while effectively and accurately describing the strategy (e.g. ‘themes’, ‘exclusions’, ‘engagement’) in plain English

Consumer facing disclosures

- **Unexpected investments**: Provide a summary of the types of holdings that the firm would reasonably expect consumers of the product to find ‘surprising’ (i.e. inconsistent with the sustainability objective), considering factors such as the sector in which the product invests or trade-offs within the sustainability profile of a company. This must be clearly signposted as ‘unexpected investments’ and include the type of investment e.g. its sector and an explanation as to why it is held in the product. Where firms do not know this information, we encourage them to conduct consumer testing to better understand the types of holdings their consumers would or would not expect the product to invest in

Consumer facing disclosures

- **Sustainability metrics**: Disclose relevant metrics/KPIs linked to achieving the sustainability objective and, where relevant, any other metrics that would help consumers to further understand the approach that the firm has taken. This must be clearly signposted as ‘sustainability metrics’. The metrics must be calculated using up-to-date data at the time of reporting and accompanied by contextual information explaining how the metrics should be interpreted
- **Signposting to other disclosures**: Cross refer/hyperlink to further information in the detailed product-level disclosures (pre-contractual and ongoing performance disclosures), entity-level disclosures, and relevant documents that set out non-sustainability-related information for the product eg costs and charges. The latter may include the key investor information document or key information document

Detailed product level disclosures

In addition to disclosures directed to retail investors, it is proposed that more detailed disclosures are available for institutional investors and other stakeholders – or retail investors that may be interested in receiving more information. These disclosures are intended to provide greater transparency on the product’s sustainability objective, strategy, and progress towards meeting the objective, as well as ongoing performance metrics and contextual information

1. Pre-contractual disclosures setting out the key sustainability-related features of a product. These disclosures would be required both for products with a sustainable investment label and those products that are not labelled, but “which have sustainability-related features that are integral to their investment strategy”

Detailed product level disclosures

2. Annual sustainability-product level reports - disclosures on the sustainability-related performance of products on an ongoing basis, in a dedicated sustainability product report which builds from the TCFD product report. This disclosure would be required for products with a sustainable investment label only
3. Entity-level disclosures, contained in a "sustainability entity report" which would discuss how firms are managing sustainability-related risks and opportunities. This requirement would build on the TCFD entity report and apply to all firms that manage investment funds in the UK with AUM of £5 billion or more on a three year rolling average, and apply regardless of whether any product of the firm has a sustainable investment label

Naming and Marketing Rules

- A general ‘anti greenwashing’ rule for all FCA regulated firms
    - This would require all regulated firms to ensure that the naming and marketing of financial products and services in the UK is clear, fair and not misleading, and consistent with the sustainability profile of the product or service (i.e. proportionate and not exaggerated)
    - By applying this rule to all FCA-regulated firms, the FCA would also be capturing firms that approve financial promotions for unauthorised persons, who will need to ensure that the promotions they approve for unauthorised persons comply with this rule as well as the financial promotions rules
    - This proposal will give the FCA an explicit rule on which to challenge firms that we consider to be potentially greenwashing their products or services, and take enforcement action against them as appropriate

Naming and Marketing Rules

- Naming rules
  - The Consultation Paper proposes prohibiting the use of “sustainability-related terms” in the naming and marketing of products offered to retail investors that do not use a sustainable investment label. Such terms would include “ESG”, “green”, or “sustainable”. In particular, this may be relevant for those entities that choose to market products with “sustainability-related features that are integral to an investment policy”, but that do not use a sustainable investment label. The Consultation Paper states that, in these instances, firms would not be permitted to use such terms in the name of the fund, but would be permitted to use them when disclosing factual information in pre-contractual disclosures
- Requirements for Distributors
  - The Consultation Paper also proposes introducing rules on distributors of certain investment products to retail investors in the UK. These rules would require such distributors to make the sustainable investment label and consumer-facing disclosures that would be required under the SDR available to those investors

Timing

- The Consultation Paper is open until 25 January 2023, with the aim of making final rules during Q2 2023
- The FCA acknowledges that many of the proposed rules will require time to enable market participants to adjust, and therefore proposes that the labelling, naming, and marketing and initial disclosure requirements would not come into effect until 30 June 2024 at the earliest
- However, the FCA proposes that the “anti-greenwashing rule” will enter into effect as soon the FCA publishes the relevant policy statement, as this rule is said to clarify existing obligations rather than introducing anything new

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PRA / FCA / Commission views on the changing regulatory landscape

Rob Moulton

State of the nation(s) – PRA, FCA, EU

- Series of stock-taking pronouncements / speeches
  - Sam Woods (PRA), Nikhil Rathi (FCA), Catherine McGuiness (Commission)
- Highlight different dynamics
- Points to developments in medium term

PRA – growth versus regulation

- A key focus (dilemma?) for the PRA
- Trade off between regulation and growth “too simplistic”
    - “Cannot be a credible international centre with watered down standards”
    - “World’s largest financial centres are not places with low standards [but they have] high and consistent standards”
    - “Competitively deregulating its self-defeating”
    - “The world is watching”
- Remuneration (bonus cap removal) is seen as good policy, rather than de-regulatory

PRA – independence

- Open contradiction of existing Government policy
  - “Be very cautious of any measure that could undermine independence”
  - “A power that allowed ministers to override regulators would...do the opposite” [of boosting competitiveness]
  - “I am ill placed [as] it looks self interested, but as a citizen of the UK, the point is true”
- Not against change as such
  - “We do not want the stability of the graveyard”

FCA – growth, competitiveness and de-regulation

- Growth should be a “secondary mandate – a primary one would undermine our international standing”
- EU reform should only be undertaken at a “steady manageable pace”
- Independence
  - Our ability to act quickly (examples given are Covid, Russian sanctions, recent market turbulence) must not be undermined by call in powers

FCA – uncertainty, and flagship projects

- FCA notes recent levels of uncertainty
  - "Last two years have been punctuated by multiple once in 100 year events"
  - Examples given include: Archegos; LME; recent Gilt uncertainty impacting Defined Benefit pensions market
- FCA flagship topics
  - Diversity (alongside conduct and culture), where Nikhil Rathi notes the diverse links between himself, the Prime Minister, and the Mayor of London
  - Consumer Duty
    - "Effort from firms now means fewer rules down the line"
  - ESG
  - EU divergence

FCA – uncertainty, and flagship projects

- FCA’s own performance
  - Emphasises that huge progress has been made on regulatory application backlog
  - The FCA has recruited 1000 new employees this year (mainly in Leeds and Edinburgh)

EU

- No explicit focus on growth or de-regulation
    - Promotion of SMEs is the nearest comparison
    - Generally intent to build upon successful post-crash reforms generally
- Sustainable finance
    - Transition to sustainable future: sustainable finance moving into the mainstream
    - Taxonomy development is challenging and will be a major centre of work
    - Corporate Sustainability Reporting Directive – reporting by companies will start to be required from 2024
    - Green investment products are too small a part of the market, so need more development

Comparisons

- Relatively stable regulatory structure in the EU
- More EU rules (upon rules), plus new developments in ESG
- Compared to relatively unstable regulatory requirement in the UK
    - Wider potential regulatory reform agenda
    - Relations between regulators and government
    - Performance of regulators in particular the FCA
    - Perhaps heading towards a better equilibrium
- Is the FCA actually facing up to views on its performance?
- Intellectual effort from the FCA aimed at: ESG; Consumer Duty; divergence; conduct and culture

Culture: A Practical Framework for Sustainable Change

An easy to use toolkit that enables organisations globally to monitor, evaluate, and shape their workplace culture.

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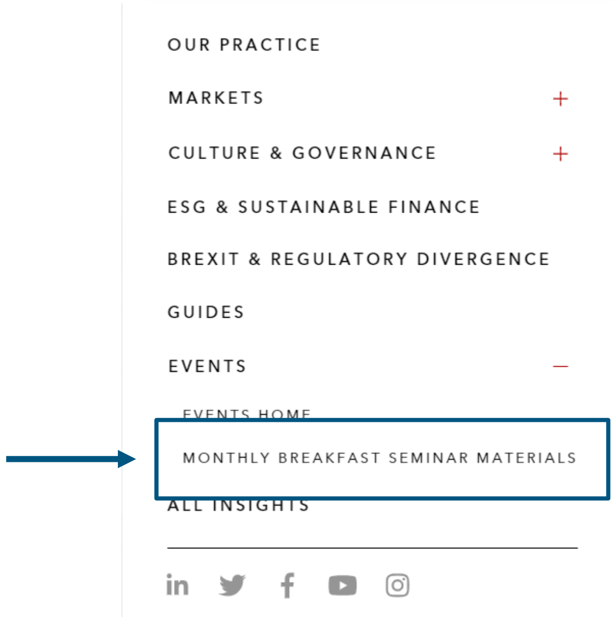
Recent Thought Leadership



[FCA Proposes New Labelling and Disclosure Rules to Combat Greenwashing in the UK]

[Sanctions Update: EU and US Impose New Sanctions and Export Controls Relating to Russia]

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