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Slaughter and May's banking and investment services column: December 2023

by Financial Regulation group, Slaughter and May

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The Financial Regulation group at Slaughter and May, including Nick Bonsall, Selmin Hakki and Emily Bradley, regularly share their thoughts with Practical Law Financial Services subscribers on topical developments in the banking and investment services sector.

In their column for December 2023, the group consider the FCA's consultation on proposed guidance relating to its new anti-greenwashing rule, the amendments to the change of control regime that were brought in by FSMA 2023, the FCA's fine of Equifax Ltd for cyber security and outsourcing failings, and the FCA and PRA consultation proposals on a new framework for diversity and inclusion (D&I) in the financial sector.

Living up to green claims

The FCA has published a consultation (GC23/3) with proposed guidance on its new anti-greenwashing rule, ESG 4.3.1R, which will come into force on 31 May 2024. ESG 4.3.1R will apply to all FCA-authorised firms making sustainability-related claims about their products or services for communication in the UK (including firms that approve financial promotions for unauthorised persons). Any reference to the sustainability characteristics of a product/service will need to be "clear, fair, not misleading" and "consistent with the sustainability profile of the product or service". In practice, this means claims will need to be:

- Correct and capable of being substantiated.
- Clear and presented in a way that can be understood.
- Complete and not omit, or hide, important information.
- Fair and meaningful in relation to any comparisons with other products or services.

Rather than imposing new requirements, the new anti-greenwashing rule reaffirms and clarifies existing expectations in the Handbook, as well as requirements under consumer protection law, relevant Advertising Codes and guidance from the Advertising Standards Authority (ASA) and the Competition and Markets Authority (CMA). The guidance suggests that the FCA is particularly concerned about the over-emphasis of the positive sustainability characteristics of a product or service, without the inclusion of countervailing information about any negative impact. This is perhaps unsurprising given the ASA's characterisation of the financial sector being a likely breeding ground for adverts that are likely to give a misleading impression of a company's overall environmental credentials, because consumers are less likely to be aware of the business's indirect contribution to emissions or other environmental harm.

The effort being expended at the regulatory level on sustainability-related disclosures and reporting requirements is increasing the quantity of disclosures being made about the sustainability characteristics of firms' activities. The FCA's new anti-greenwashing rule and accompanying guidance are a reminder that that firms will need to disclose not just more, but better, or be held to account.

Changing change in control

Among the many changes brought about by the Financial Services and Markets Act 2023 (FSMA 2023) is an adjustment to the change in control regime that deserves a mention in this column. New section 187(2)(aa) of the Financial Services and Markets Act 2000 (FSMA) allows the (appropriate) regulator to impose conditions on a change in control approval when "it is desirable to impose those conditions in order to advance any of that regulator's objectives". This could include "situations where the evidence may not reach the "reasonable grounds" threshold needed to reject a decision, but the relevant regulator still has significant concerns"

(according to the FSMA 2023 explanatory notes). The recent FCA-PRA joint consultation (CP25/23 / CP23/23) on the prudential assessment of acquisitions and increases in control suggest that this new power might be used "where there are outstanding matters the effect of which on the transaction are uncertain, [f]or example, when there are outstanding proceedings against a proposed acquirer".

An early parliamentary debate on FSMA 2023 provides some further context to the change. It is designed to: "fill a gap in the regime identified by the PRA and the House of Commons Treasury Select Committee in its Greensill inquiry" and "give the regulators more flexibility to manage changes of control in a way that they consider appropriate with reference to their statutory objectives". The Treasury Committee report on Greensill also said: "As a matter of urgency, there should be reform of the change in control process which regulates who can acquire the ownership of an already existing bank. This should ensure that the PRA has the powers necessary to ensure that existing banks do not fall into the hands of owners who would not be granted a banking licence in their own right."

This amendment has applied to applications received on or after 29 August 2023. It feels like more than a small technicality and offers the regulators a significantly more robust approach to the review of acquisitions, widening the basis upon which conditional approval may be given. The next few months may reveal the full practical impact of the change.

Waking up to Equifax

In October, the FCA published a final notice fining Equifax Ltd (Equifax) £11,164,400 for failing to manage and monitor the security of UK consumer data outsourced to its US-based parent Equifax Inc., six years after the investigation was first announced.

In September 2017, Equifax Inc. revealed that it had been subject to one of the largest cybersecurity breaches in history in a "foreseeable and entirely preventable" attack. The personal data accessed by cyber-hackers had been outsourced by Equifax to its US parent's servers for storage and processing. Despite being alerted to the hacking six weeks prior, Equifax Inc. only informed Equifax of the breach five minutes before it publicly announced the incident. The short notice left Equifax unable to cope with the complaints it received following the announcement and led to delays in contacting UK customers. For a fuller recap of the facts, see our blog post.

The FCA concluded that Equifax had breached Principles 3, 6 and 7 of its Principles for Businesses; not only for failing to exercise appropriate oversight of the outsourcing arrangement, but for exposing customers to the risk of unfair outcomes (it ceased quality assurance checks of the complaints handling process in the aftermath of the announcement; it also published several public statements following the incident which gave an inaccurate impression of the number of individuals affected).

The headline message on this story for regulated firms is surely to monitor and manage the security of outsourced data in any outsourcing arrangements, even in an intra-group context. It also seems inevitable with the advent of the consumer duty that firms' communications with customers in the aftermath of a cybersecurity crisis and remedial action will be subject to enhanced regulatory scrutiny.

What really made us sit up and take notice is that the fact that Information Commissioner's Office (ICO) had already issued a £500,000 fine to Equifax (the maximum penalty available under the old Data Protection Act 1998) in September 2018. The FCA's £16,400,000 fine issued to Tesco Bank in 2018 is the most recent, notable pre-Equifax example of FCA enforcement action in the cyber space, but firms cannot now assume that enforcement action for cybersecurity failings will be limited to, or even led by, the ICO.

Making financial services diverse and inclusive

Finally, let's turn to the PRA and FCA's proposals in CP23/20 and CP18/23 for action on diversity and inclusion (D&I) in financial services firms, which are open for consultation until 18 December 2023 and build on their July 2021 discussion paper (DP21/2) (which was jointly issued with the Bank of England in its capacity of supervising financial market infrastructure firms (FMIs)).

Notably, only the largest firms (those with 251 or more employees based in the UK) would be subject to the full spectrum of measures. This threshold applies on a solo basis and leaves out a whole swathe of small and medium sized firms that employ the vast majority of financial services professionals in the UK. Those firms that are caught in the net would need to figure out what underrepresentation looks like for their context and set "both realistic and stretching" targets for relevant demographic characteristics. They would be required to report on certain D&I metrics and the potentially more

nebulous concept of inclusion. Also bound up in the CPs are proposals related to non-financial misconduct, which would apply to firms of all sizes, but we'll save discussion of those for another column.

Some respondents may find themselves probing the notion that these proposals are rooted in the regulators' statutory objectives, a claim that is never fully substantiated in the CPs. The PRA says that D&I translates into "more effective and prudent decision-making and risk management". Groupthink and lack of inclusion can, it argues, lead to firms missing risks that could threaten firm safety and soundness and/or policyholder protection. Meanwhile, the FCA explains that: "greater levels of diversity and inclusion can improve outcomes for markets and consumers... by helping reduce groupthink, supporting healthy work cultures, improving understanding of and provision for diverse consumer needs and unlocking diverse talent, supporting the competitiveness of the UK's financial services sector." The FCA also alludes to a link with the consumer duty: based on the premise that firms drawing on diverse perspectives better reflect their customers' needs (the theory being that this ought to result in better customer outcomes).

These CPs mark an important step towards making more substantive progress on D&I in the financial sector, but there is much more that can be done to drive meaningful improvements than the measures that are imagined.