

A blue-toned background image featuring a financial line chart with multiple data series plotted against a grid. The lines show various trends, including a sharp decline on the left and a more volatile, upward-trending section on the right.

LATHAM & WATKINS

13 September 2023

Financial Regulation Monthly Breakfast Seminar

Overview



A blue line graph is plotted on a dark blue background with a lighter blue grid. The line starts at the top left, dips, rises to a peak, dips again, and then rises to a higher peak before trending downwards. The graph is composed of two distinct line styles: a solid blue line and a dotted blue line.

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The government's proposals to ban cold calling in
relation to consumer financial services and products
Ella McGinn

Cold calling ban

- The government is consulting on a **wide reaching cold calling ban** to combat the use of cold calling by fraudsters to manipulate the public into purchasing scam financial services and products
- The ban is intended to fill gaps that exist within the current prohibitions to ensure that:
 - Consumers will know that no legitimate firm will contact them to market financial services or products in an **unsolicited manner**
 - Consumers feel empowered to terminate and report as a scam any financial services cold call that they receive
 - Legitimate businesses have a **clear set of restrictions** to follow when marketing financial products
 - Enforcement action can be taken against UK firms which continue to cold call consumers to market financial products and services
 - Scammers have no opportunity to **claim they are acting outside the prohibition** by changing the financial product they focus on

Cold calling ban – current framework

- The existing ‘patchwork’ approach to cold calling restrictions (regulated by the ICO, FCA and Ofcom) can be confusing and make it difficult for a consumer to know when an unsolicited marketing call for a financial product could be a **legitimate approach**
 - Privacy and Electronic Communications Regulations (PECR)
 - ICO pensions and claims management services cold calling restrictions
 - FCA financial promotions restrictions on cold calling for specific products
 - Ofcom powers to take enforcement action under the Communications Act 2003 against a person who has persistently misused a communications network or service

Cold calling ban – scope of the ban (1)

- A new blanket ban on live ‘unsolicited calls to an individual for direct marketing’ would create a single framework to achieve greater clarity for consumers and to allow for simple messaging to consumers that **all unsolicited marketing calls for financial services and products are illegal and are a scam**
- This will likely **extend beyond FCA regulated services and products**
- Some intended **in-scope** products and services include:
 - Any product or service of a banking or payments nature, including electronic money and cryptoassets
 - Mortgages and insurance, as well as white goods warranties and protection plans
 - Investments, including tangible items where these are marketed in the manner of an investment
 - Credit and debt, including individual voluntary arrangements

Cold calling ban – scope of the ban (2)

- The wide scope may have potential negative impacts on business practices which create value for the consumer, such as advising on alternative products better suited to a customer's needs
- B2B cold calling is not intended to be covered by the ban, but views are sought on the classification of sole traders and other partnership types as consumers (in scope) or businesses (not in scope)
- Potential exception for FCA & PRA authorised businesses when the business and the receiver of the call have an “**established existing client relationship**” and the recipient envisages receiving cold calls

Cold calling ban – scope of the ban (3)

- Non-marketing activities will not be in-scope of the ban, meaning that:
 - Tracing and reunification activities to reconnect customers with previous financial products and services are permitted
 - The ability of firms to send routine customer service or administrative messages (i.e. informing a customer when a product contract is coming to an end) will not be impacted
- The ban will not apply where the consumer has **knowingly and freely given clear and specific consent** to be contacted for marketing purposes (GDPR standard of consent)

Cold calling ban – scope of the ban (3) (cont.)

- Social media video and voice calls may provide similar opportunities for scammers in real time – however this could delay the ban if it requires a separate legislative approach
- Cold calling could also take place on live, electronic communications
- Non-live communications (i.e. emails and texts) are being separately addressed – (e.g. banning SIM farms)

Cold calling ban – implementation

- The ban is intended to be enacted through an amendment to the PECR (similar to pensions)
- ICO to act as the enforcement agency as it has power under the Data Protection Act 2018 to enforce the PECR and fine offenders up to £500,000
- ICO power will extend to lead generators, who are the main instigators of financial product and service cold calls
- ICO to determine if any consent given is valid or remains valid if previously given – no specific time limits but firms should conduct regular consent reviews

Cold calling ban – next steps

- The consultation will close on **27 September 2023**
- Looking ahead, so that the ban is effective in combating fraudsters, the public need to be aware that cold calls they receive regarding financial services and products are illegitimate, and likely to be a scam
- Government is proposing to tackle consumer awareness and understanding primarily through:
 - Financial services and product providers
 - Government-backed guidance providers
 - The FCA's 'ScamSmart' campaign
 - Non-government bodies such as charities
 - ICO campaigns

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Recent ESG developments, including EU proposals to
regulate ESG ratings providers
Nicola Higgs

EU: ESG Ratings Regulation

- **Proposed scope:** ESG ratings issued by ESG rating providers operating in the EU that are disclosed publicly or are distributed to financial undertakings in the EU
- **Definition of “ESG rating”:** “an opinion, a score or a combination of both, regarding an entity, a financial instrument, a financial product, or an undertaking’s ESG profile or characteristics or exposure to ESG risks or the impact on people, society and the environment, that are based on an established methodology and defined ranking system of rating categories and that are provided to third parties, irrespective of whether such ESG rating is explicitly labelled as ‘rating’ or ‘ESG score’”
- **Explicit exclusions from the scope of the proposed Regulation**

EU: ESG Ratings Regulation - Key proposals

- **Authorisation**
 - Equivalence, endorsement or recognition proposed for third country entities
- **Independence of rating activities**
 - Ensure the independence of rating activities, including from all political and economic influences or constraints
- **Transparency**
 - ESG rating providers will be required to disclose both to users and on their website the methodologies, models, and key rating assumptions they use in their ESG rating activities

EU: ESG Ratings Regulation - Key proposals (cont.)

- **Separation of business and activities**
 - Prohibition on ESG rating providers from engaging in certain activities
- **Supervision**
 - ESMA will be responsible for the ongoing supervision of EU ESG rating providers and will be able to impose fines for infringements of the Regulation

Draft Voluntary Code of Conduct for ESG Ratings and Data Product Providers

- 6 July 2023: The ESG Data and Ratings Code of Conduct Working Group (DRWG), supported by the International Regulatory Strategy Group (IRSG) and the International Capital Market Association (ICMA), launched for consultation a draft voluntary Code of Conduct for ESG data and ratings providers
- The FCA welcomed the Consultation, having appointed ICMA and the IRSG to convene an industry group to develop a voluntary code in 2022
- The consultation period closes on 5 October 2023

Draft Voluntary Code of Conduct for ESG Ratings and Data Product Providers (cont.)

The Code of Conduct is underlined by 6 Principles, each is underpinned by a series of recommended actions and outcomes:

No.	Principle
1.	Good governance ESG ratings and data products providers should ensure appropriate governance arrangements are in place that enable them to promote and uphold the Principles and overall objectives of the Code of Conduct
2.	Securing quality (systems and controls) ESG ratings and data products providers should adopt and implement written policies and procedures designed to help ensure the issuance of high quality ESG ratings and data products

Draft Voluntary Code of Conduct for ESG Ratings and Data Product Providers (cont.)

No.	Principle
3.	<p data-bbox="231 368 631 408">Conflicts of interest</p> <p data-bbox="231 472 2481 715">ESG ratings and data products providers should adopt and implement written policies and procedures designed to help ensure their decisions are independent, free from political or economic interference, and appropriately address actual or potential conflicts of interest that may arise from, among other things, the ESG ratings and data products providers' organisational structure, business or financial activities, or the financial interests of the ESG ratings and data products providers and their officers and employees</p> <p data-bbox="231 779 2481 915">ESG ratings and data products providers should identify, avoid or appropriately manage, mitigate and disclose actual or potential conflicts of interest that may compromise the independence and integrity of the ESG ratings and data products providers' operations</p>
4.	<p data-bbox="231 1001 504 1041">Transparency</p> <p data-bbox="231 1105 2481 1286">ESG ratings and data products providers should make adequate levels of public disclosure and transparency a priority for their ESG ratings and data products, including their methodologies and processes to enable the users of the product to understand what the product is and how it is produced, including any potential conflicts of interest and while maintaining a balance with respect to proprietary or confidential information, data and methodologies</p>

Draft Voluntary Code of Conduct for ESG Ratings and Data Product Providers (cont.)

No.	Principle
5.	<p>Confidentiality (systems and controls)</p> <p>ESG ratings and data products providers should adopt and implement written policies and procedures designed to address and protect all non-public information received from or communicated to them by any entity, or its agents, related to their ESG ratings and data products, in a manner appropriate in the circumstances</p>
6.	<p>Engagement (systems and controls)</p> <p>ESG ratings and data products providers should regularly consider whether their information gathering processes with entities covered by their products leads to efficient information procurement for both the providers and these entities. Where potential improvements to information gathering processes are identified, ESG ratings and data products providers should consider what measures can be taken to implement them</p> <p>Where feasible and appropriate, ESG ratings and data products providers should respond to and address issues flagged by entities covered by their ESG ratings and data products while maintaining the independence and integrity of these products</p>

Other ESG developments: UK Taxonomy

UK Green Taxonomy

- Green Technical Advisory Group (GTAG) report published September 2023, advises:
 - Taxonomy reporting should apply to companies subject to mandatory Taskforce on Climate-related Financial Disclosures (TCFD) reporting
 - Both frameworks will be integrated under the UK's Sustainability Disclosure Requirements (SDR) regime, with correct phasing in of reporting obligations necessary to ensure businesses have time to adjust and financial institutions have the information needed to facilitate their own reporting
 - GTAG advises: non-financial companies should report on taxonomy eligibility in year 1; reports on taxonomy eligibility by financial institutions and taxonomy alignment by non-financial services companies should follow in year 2; and taxonomy alignment by financial institutions should follow in year 3

Other ESG developments: UK Taxonomy (cont.)

UK Green Taxonomy

- Green Technical Advisory Group (GTAG) report published September 2023, advises:
 - The SDR framework should factor in existing industry feedback on the EU Taxonomy KPIs when developing UK equivalents, to improve their usability, comparability and usefulness. The process must also set clear, consistent definitions for these KPIs to ensure meaningful and comparable reporting across various accounting frameworks. Technical experts at the FCA should lead this work
 - The costs and benefits of expanding KPIs to data provided on a voluntary basis by entities not covered by SDR should be considered

Other ESG developments: NGFS Report

NGFS Report on Climate Related Litigation Risks

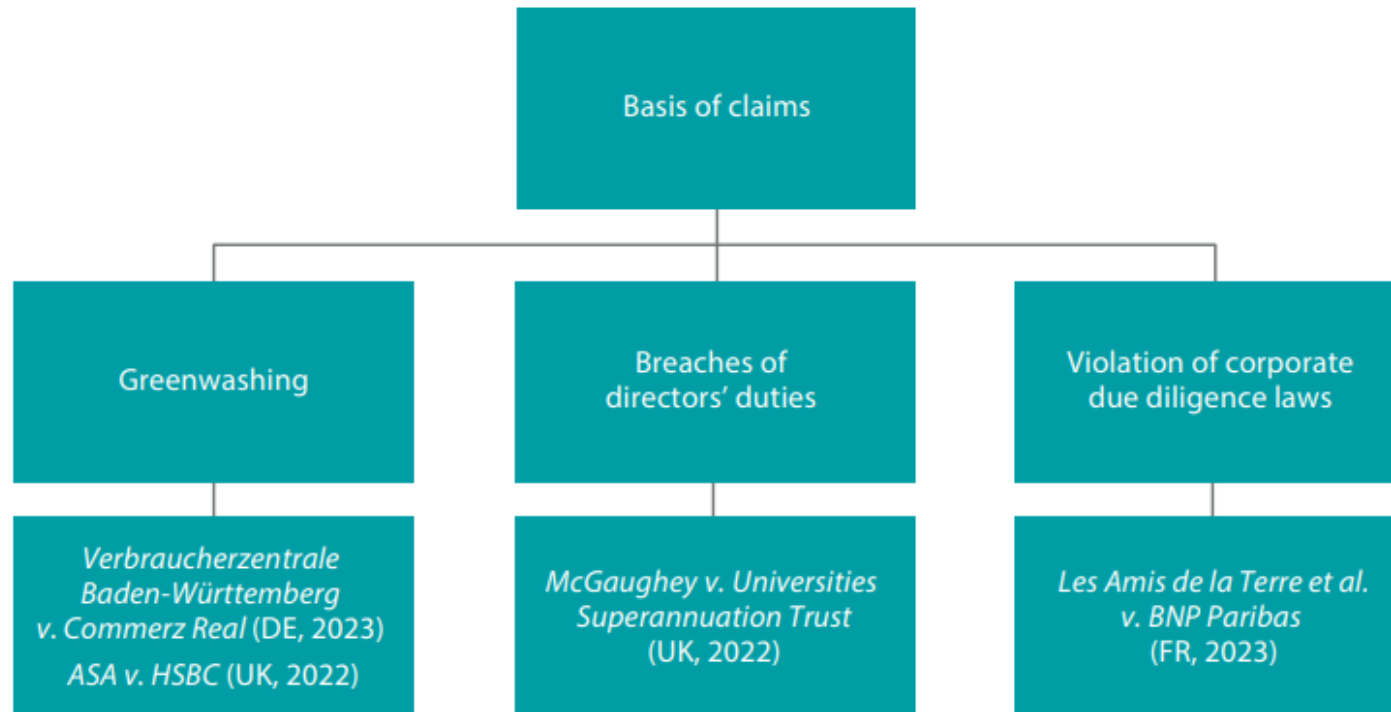
- Report 1: Outlines recent trends in the area, highlighting the rise in climate-related litigations
- Report 2: Drawing the conclusion from these developments, focuses on the micro-prudential supervision of the risks for financial institutions associated with the increase in climate-related litigations

Chiara Zilioli, General Counsel of the European Central Bank:

“As climate and environment-related litigation continues to expand across jurisdictions and economic sectors, the impact on the financial sector is becoming ever more evident. It is crucial for central banks, supervisors and financial institutions to be aware of these trends, and to take action to address these risks.”

Other ESG developments: NGFS Report

Trends in climate related litigation against financial institutions



Source: https://www.ngfs.net/sites/default/files/medias/documents/ngfs_report-on-climate-related-litigation-recent-trends-and-developments.pdf

A blue line graph is plotted on a dark blue background with a lighter blue grid. The graph shows a line that starts high on the left, dips, rises to a peak, dips again, and then rises to a higher peak on the right. The line is thick and has a slight glow.

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The interim findings from the FCA's Wholesale Data
Market Study
Becky Critchley

Highlights

- Recap
 - The FCA launched its study in March 2023 to investigate potential competition problems in the markets for benchmarks, credit ratings data and market data vendor services
- Provisionally no referral to the Competition and Markets Authority
- Provisionally identified competition concerns
- Similar concerns noted by regulators in other countries
- Elements of each market exhibit persistent concentration
- Retail hook

Benchmark administrators

- FCA will investigate the following areas further:
 - Barriers to switching
 - Recent market trends and developments
 - Concentration and persistent market power
 - Network effects
 - Brand awareness
 - Barriers to new entrants
 - Vertical integration
 - Commercial practices
 - Non-transparent pricing
 - Bundling of products
 - Burdensome termination clauses
 - Quality concerns
 - Parallel review on the quality of benchmark data

Credit ratings data

- FCA will investigate the following areas further:
 - Recent market trends and developments
 - Concentration and market power
 - Substitutability
 - Free credit ratings data
 - Vertical integration
 - Barriers to entry
 - Commercial practices
 - Complex, non-standard and non-transparent pricing
 - Excessive licensing fees and annual price increases

Market data vendors

- FCA will investigate the following areas further:
 - Barriers to switching
 - Recent market trends and developments
 - Concentration and persistent market power
 - Barriers to entry
 - Network effects
 - Switching
 - Vertical integration
 - Innovation
 - Commercial practices
 - Tying and bundling practices
 - Complex and non-transparent pricing

What next?

- Stakeholders can provide comments to the FCA by 29 September 2023 on:
 - The FCA's provisional decision not to make a referral to the CMA, and/or
 - Any of the emerging themes and issues set out in the Report
- FCA will continue to investigate the market and further work will include:
 - Assessing customers' behaviour to understand whether they can (and do) switch between suppliers and products
 - Assessing suppliers' use of complex and non-transparent contracts and licensing terms
 - Considering the value users get from bundled products and services given that these also create barriers to entry or expansion
 - Assessing what options are available to encourage greater competition in areas where potential harm is identified

What next? (cont.)

- FCA's final findings and conclusions to be published by 1 March 2024
- Firm specific engagement

A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart is partially obscured by a dark blue horizontal band containing text.

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A financial crime update, including the FCA's findings from its assessment of firms' sanctions systems and controls
Jonathan Ritson-Candler

Three recent FCA publications

1. FCA launched review of the treatment of UK domestic PEPs on 5 September, with review due to report by the end of June 2024
2. FCA published examples of good and poor practice relating to firms' sanctions systems and controls on 6 September, focussing on firms' response to increased sanctions due to Russia's invasion of Ukraine
3. Sarah Pritchard, Executive Director of markets and international, gave a speech on 6 September at the Financial Crime Summit 2023 on calibrating controls to build confident markets

1. UK domestic PEP review

Existing regulatory landscape

- MLD4 brought about a change compared to MLD3 in that UK PEPs* as well as non-UK PEPs are required to be subject to enhanced due diligence (EDD)
- The FCA published FG17/6 in July 2017 providing guidance on the treatment of PEPs
- That guidance makes clear that firms should take a risk-based approach to identifying PEPs and applying EDD and reiterates that firms should assess the risk of PEPs on a **case-by-case** basis and that **applying a generic approach to all PEPs** is not appropriate

*Note all references to PEPs include family members and known close associates

1. UK domestic PEP review (cont.)

Existing regulatory landscape

- The guidance goes on to clarify the definition of a PEP (holding prominent public functions only)
- FCA's view is that it is unlikely in practice that a large number of UK customers should be treated as PEPs
- There should be no automatic assessment that a UK PEP presents a high risk of money laundering
- The starting position should, in fact, be that UK PEPs present a commensurately lower risk and apply EDD on that basis (as long as there are no other risk factors outside of their status as a UK PEP)
- Firms should not decline or close a business relationship merely because a person meets the definition of a PEP

1. UK domestic PEP review (cont.)

FCA announces review

- Concern that firms may not be treating UK PEPs on an individual / case-by-case basis, instead applying a one size fits all approach, marking UK PEPs as higher risk and potentially excluding them from products or services “through no fault of their own”
- FCA concerned firms are using “standardised questionnaires” that may not sufficiently recognise position for UK PEPs
- FCA expects firms to be able to explain how they are appropriately implementing their AML controls under the MLRs 2017 and how these meet the Consumer Duty

1. UK domestic PEP review (cont.)

FCA announces review

- FCA's review will focus on whether firms are:
 - Correctly defining / identifying PEPs
 - Conducting proportionate risk assessments including consideration of risk factors beyond the person being a PEP
 - Carrying out risk-based and proportionate EDD
 - Applying enhanced ongoing monitoring to PEPs and keeping EDD up to date
 - Deciding to reject or close accounts for PEPs to check those decisions are in line with rules / guidance and the Consumer Duty
 - Effectively communicating with PEP customers
 - Keeping PEP controls under review to ensure they remain appropriate including how senior management are informed about and oversee the operation of PEP controls
- FCA is also going to consult with UK PEPs and the FOS

2. Sanctions controls: good and poor practice

- FCA has assessed the sanctions systems and controls of over 90 firms across a range of sectors
- Using a mix of acting on firm-specific intelligence as well as utilising the FCA's Sanctions Screening Tool, a system developed in-house for testing how effective firms are at identifying sanctions targets using test data
- This is the FCA's response to the unprecedented size, scale and complexity of sanctions measures introduced following Russia's invasion of Ukraine

2. Sanctions controls: good and poor practice (cont.)

	Good practice	Poor practice
Governance and oversight	<ul style="list-style-type: none">✓ Proactive risk assessments and scenario planning in advance of Russian invasion + ongoing horizon scanning means firms were more responsive and could act quickly✓ MI containing sufficiently granular information and calibrated to the UK regime	<ul style="list-style-type: none">✗ Senior management having insufficient MI to discharge oversight responsibilities (e.g., lacking basic metrics - number of sanctions alerts, number awaiting analysis and number of reports issued to OFSI)✗ Reliance on inappropriately calibrated group wide / international systems, controls, policies and procedures✗ Senior management unable to understand sanctions risks applicable to their firm
Skills and resources	<ul style="list-style-type: none">✓ Adequately resourced sanctions teams to avoid backlogs in dealing with sanctions alerts and otherwise enable a quick reaction to sanctions risks	<ul style="list-style-type: none">✗ Resource strain resulted in lack of clarity on prioritisation of alerts✗ Increased volumes and pressure on sanctions teams can prevent firms taking appropriate and timely action for true positive alerts and increases the risk of errors

2. Sanctions controls: good and poor practice (cont.)

	Good practice	Poor practice
Screening capabilities	<ul style="list-style-type: none"> ✓ Able to clearly articulate and demonstrate how sanctions screening tools have been calibrated to the sanctions risks applicable to the firm ✓ Able to show measures in place to measure the effectiveness of sanctions screening thresholds (including testing and tuning) ✓ Built in fuzzy logic to help identify name variations for sanctioned entities and individuals 	<ul style="list-style-type: none"> ✗ Over-reliance on third party screening tools which led to firms lacking understanding how screening tools are calibrated and how and when lists are updated ✗ Resulting in firms being unable to demonstrate they were screening against correct lists etc. ✗ Inadequate testing and oversight of third party solutions ✗ High numbers of false positives indicates improper logic in tool and strains teams
CDD / KYC	<ul style="list-style-type: none"> ✓ Thorough, timely and complete CDD enables effective compliance with sanctions screening requirements ✓ Documenting false positives and outcomes 	<ul style="list-style-type: none"> ✗ Backlogs created by increased number of sanctions hits (see false positives above) ✗ Low quality of assessments (not identifying full structure to ensure screening all parties)
Reporting breaches to the FCA	<ul style="list-style-type: none"> ✓ Firms must report knowledge or reasonable cause to suspect breach of sanctions to FCA and OFSI promptly 	<ul style="list-style-type: none"> ✗ FCA observed instances of it taking weeks or months to report

3. Speech: calibrating controls to build confident markets

- Reiterates messaging from domestic UK PEP review and good and poor practices for sanctions systems and controls
- Tells firms to expect spot checks of financial crime systems and controls (broad and could capture AML, filings of SARs, sanctions, market abuse, fraud etc.)
- Emphasises FCA's role as a data-led regulator and that it is using data and tech to test firms' systems and controls
- Financial crime compliance is a risk-based calibration, and not a tick-box, exercise
- Financial crime is a “key super-charged priority” for 2024

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The FCA's portfolio letters on its supervisory
strategies for principal trading firms and the
wholesale banking sector
Rob Moulton

Portfolio letter: principal trading firms

- Market abuse – an “inherent driver of harm across all firms in the portfolio”
 - FCA has identified some firms with “weaknesses in governance and controls”, which need a “mindset shift”
- Algo trading
 - FCA to carry out a targeted review of compliance with RTS 6 and 7
- Financial resilience
 - Many firms have limited market exposure, but others have significant exposures
 - Capital and liquidity risk management are seen as the key controls
 - FCA to do a targeted review of financial resilience, IFPR implementation, and resolution planning over the next year

Portfolio letter: principal trading firms (cont.)

- Operational resilience
 - Focus on cyber and fraud prevention
 - Reminder of 31 March 2025 deadline for operational resilience rule compliance
- Brexit
 - Has led to increasingly complex cross-border models (UK SMCR responsibility and clarity seen as a key control)
- Next steps
 - FCA expects all CEOs to have had, and documented, board discussions, with agreed actions, by end of September 2023

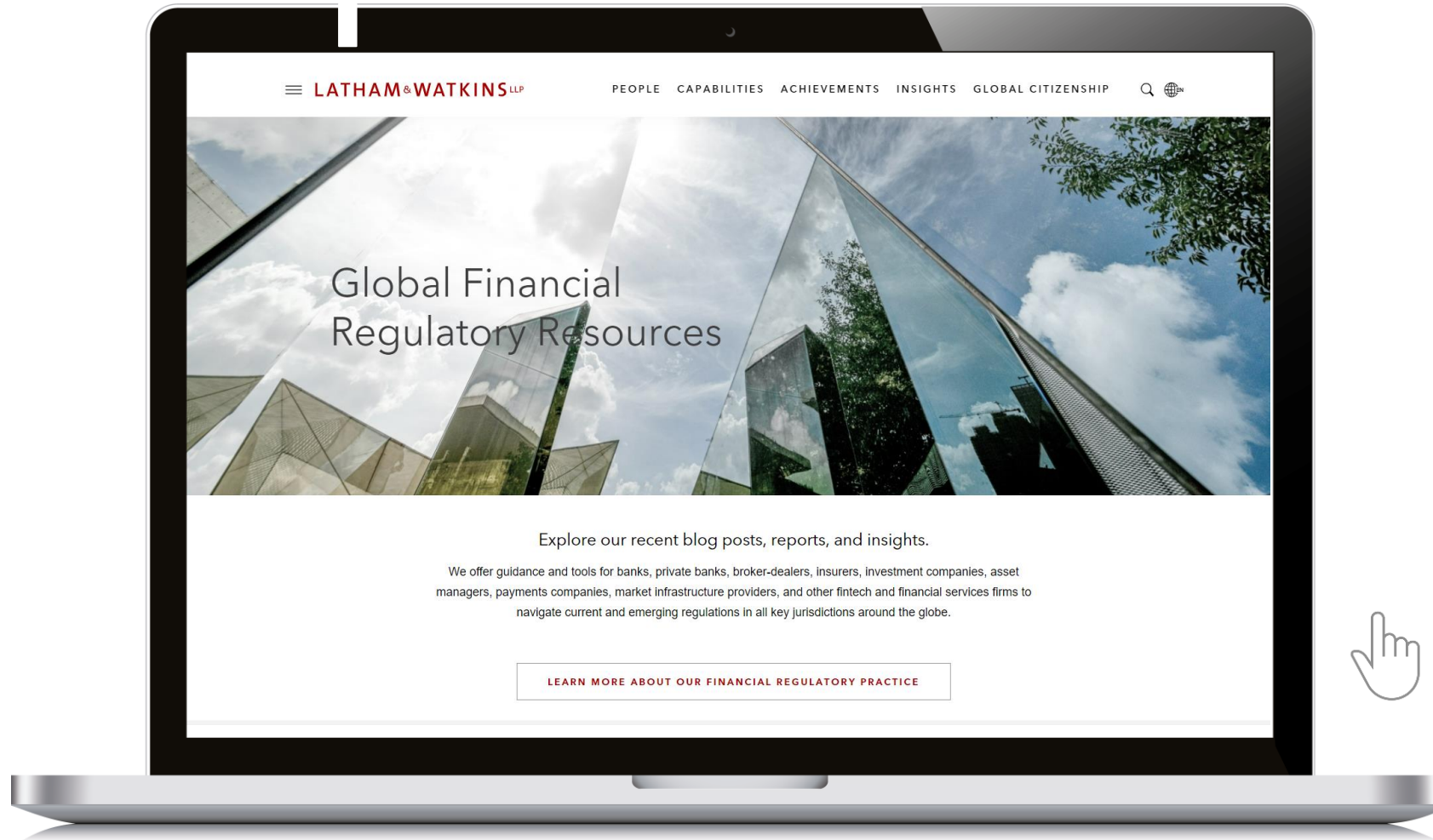
Portfolio letter: wholesale banks

- Risk management
 - Reminder of Dear CEO letter on Global Equity Finance
 - Problems with: inadequate knowledge of clients; missing concentrated risks by linked entities; and underestimating concentration in markets with limited players, who may react uniformly to market events
 - FCA looking to boards to have evidence of lasting improvement in these areas
- Managing conduct risks in a downturn
 - Short term financial pressures have been seen to lead to “conduct standards reducing”
 - Highlights blurring of responsibilities between first and second line (e.g., in ESG)
 - Plea for prompt notifications directly from second line heads to the board

Portfolio letter: wholesale banks (cont.)

- Operational resilience
 - As with PTF letter
 - With additional plea for prompt notification of cyber attacks
- Organisational changes / Brexit
 - Booking model complexity and SMCR responsibility highlighted
- Diversity, equality and inclusion, and non-financial misconduct remain key priorities
- By end October, CEOs should have discussed with the board and documented action points

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