

## REGULATORY INTELLIGENCE

## The UK regulator's enhanced focus on ESG issues

Published 01-Dec-2022 by

James Alleyne and Katherine Tyler, Kingsley Napley LLP.

The Financial Conduct Authority (FCA) invited expert applications for a new environmental, social and governance (ESG) advisory committee in August 2022. The committee will help it shape and deliver on its ESG-related responsibilities and objectives, in support of the government's ambition to achieve a net zero economy by 2050.

If that was not a sufficiently clear signal of the increasing importance the FCA board attaches to ESG, further evidence was its subsequent announcement in October's [consultation paper CP22/20](#) about a new package of measures to apply widely across the regulated financial services sector and designed to enhance the regulatory infrastructure for ESG concerns.

Central to this consultation is a proposed new general anti-greenwashing rule, which will apply to all regulated firms from June 30, 2023 and will give the FCA an explicit regulatory hook on which to hang potential supervisory or enforcement action for firms engaging in greenwashing. The FCA is also proposing a suite of detailed new rules relating to sustainability disclosure requirements, consumer-facing disclosures and investment labels.

These are likely to be implemented for portfolio managers, undertakings for collective investment in transferable securities (UCITS) managers and alternative investment fund managers (AIFMs) using a staged approach from June 30, 2024 and which will increase the compliance burden on — and regulatory risk for — firms operating in these sectors.

### U.S. and German enforcement action

The FCA is not the only financial regulator grappling with how to maintain consumer confidence in a market where there are obvious short-term gains to be made from greenwashing. In March 2021 the U.S. Securities and Exchange Commission (SEC) [announced](#) the creation of a Climate and ESG Enforcement Task Force with a remit to identify ESG-related misconduct. Since then the SEC has [filed](#) a number of ESG-related enforcement actions and begun the process of creating expansive new [climate disclosure rules](#).

Enforcement action has included, in April 2022, a case against [Vale S.A.](#), a publicly traded Brazilian mining company charged with making false and misleading claims about the safety of one of its dams in its public sustainability reports and other public documents. In May 2022, a case was brought against [BNY Mellon Investment Adviser](#) for representing or implying in various statements "that all investments in certain funds had undergone an ESG quality review when that was not always the case".

These two cases reflect the focus areas identified by the task force when it was first announced, and which have gone on to characterise reported further enforcement action, specifically material gaps or misstatements in issuers' disclosures and secondly disclosure and compliance risks relating to investment advisers' and funds' ESG strategies.[1] Both of these would also be concerns for the FCA and are likely to sit at the heart of its ESG enforcement strategy.

The German financial regulator, BaFin, has also taken enforcement action in this area. Deutsche Bank's asset management division, DWS, was [reported](#) to have been raided by German prosecutors in May 2022 as part of an investigation by BaFin. The FCA is likely to take similar action against other offending organisations, as appropriate, in the future.

### Powerful toolkit

The proposed future rules set out in CP22/20 will enhance the FCA's ability to act, but it should be noted that the existing regulatory and statutory framework already provides the FCA with a broad range of powers that could be applied to greenwashing or wider ESG issues (including governance, and diversity and inclusion).

Indeed, given its increasingly assertive supervisory approach under chief executive Nikhil Rathi, there is no reason to think the FCA will wait for new rules to come into force before it seeks to intervene or take enforcement action against greenwashing or other issues falling within the broader ESG definition.

For instance, Principle 7 of the [Principles for Businesses](#), which requires authorised firms to pay due regard to the information needs of clients, could be used to enforce against firms for producing misleading advertising about the green or sustainable credentials of particular investments or products.

Similarly, Principle 3, which places a high-level obligation on regulated firms to "take reasonable care to organise and control their affairs reasonably and effectively" could be potentially be cited in support of enforcement action against firms which, for instance, lack effective management oversight of climate-related disclosures or which have inadequate resource, systems or controls in place to monitor — for example — diversity and inclusion.



THOMSON REUTERS™

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

There is also the possibility of a criminal prosecution or other regulatory investigation for greenwashing. In the context of criminal prosecution, s 89 of the [Financial Services Act 2012](#) created a criminal offence for knowingly making a false or misleading statement, which could include mislabelling financial products as "green" or "sustainable", while the various offences under the [Fraud Act 2006](#) are sufficiently broadly drafted to encompass a range of ESG-related acts and omissions.

### **Misleading environmental claims**

In the context of other possible enforcement action both the Competition and Markets Authority (CMA) and the Advertising Standards Authority (ASA) have also been making efforts to tackle businesses that make misleading environmental claims. For example, in September 2021 the CMA announced the [Green Claims Code](#) and commenced its first [investigation](#) under that code in July 2022.

In December 2021, meanwhile, the Committee of Advertising Practice and Broadcast Committee of Advertising Practice published [advertising guidance](#) on misleading environmental claims and social responsibility to assist with interpreting their rules on environment-related advertising issues.

Since then the ASA has made a number of findings of greenwashing, including against a financial institution.[2] Such legislation and guidance reinforces the importance of firms accurately and appropriately using ESG labels for their products.

### **FCA powers of intervention**

From a practical standpoint, such cases, whether civil, regulatory or criminal, typically take months or even years to conclude and, by definition, take place after the event once the harm has crystallised. The FCA's statutory toolkit also contains various — potentially draconian — powers that allow it to intervene in real time against continuing risks. This includes the power to unilaterally remove a firm's regulatory permissions, a broad general power to impose requirements on firms and also a specific power to ban misleading financial promotions.

The use of such powers by the regulator can result in serious costs and disruption to firms and their customers, as well as adverse publicity. The FCA has been far more willing in recent years to deploy such powers against what it considers to be unacceptable levels of risk to consumers or markets.

With an already powerful toolkit — and one which will only become stronger as new rules come into force — and an increasingly clear mandate, it seems unlikely that ESG will move down the FCA's priority list in the foreseeable future. As it becomes increasingly important to meet emissions targets there is likely to be even greater scrutiny of ESG disclosures. Regulated firms should be embedding ESG compliance throughout their operations now, or potentially be prepared to face serious consequences.

*The authors are [James Alleyne](#) (legal director, financial services) and [Katherine Tyler](#) (legal director, ESG) in the criminal litigation team at [Kingsley Napley LLP](#).*

*[1] [Click here to view this document](#), see also Acting Head of the ESG Task Force, Kelly Gibson's interview with the Environmental Law Institute in November 2021, available at the People, Places, Planet Podcast, Series 3, Episode 20.*

*[2] See, for example the ASA's decisions in respect of [Unilever UK Ltd](#) and [HSBC](#).*

[Complaints Procedure](#)

Produced by Thomson Reuters Accelus Regulatory Intelligence

01-Dec-2022



THOMSON REUTERS™

© 2022 Thomson Reuters. No claim to original U.S. Government Works.