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REGULATORY

FCA publishes final guidance on its anti-greenwashing rule

The FCA has recently published its finalised non-handbook guidance on its anti-greenwashing rule which comes into force on 31 May 2024. In this article we discuss the guidance and its implications for the insurance sector.

The anti-greenwashing rule

The anti-greenwashing rule obliges firms to ensure that any sustainability-related claims about a product or service are consistent with the actual sustainability characteristics of that product or service, and that such claims are fair, clear and not misleading. Ultimately, this means that, where a firm makes a sustainability-related claim about a product or service, it must have appropriate evidence to substantiate those claims.

The FCA regards addressing greenwashing as a priority. The overarching aim of the anti-greenwashing rule is to protect consumers against sustainability-related claims that may be exaggerated, misleading and/or unsubstantiated. Secondary to this, the FCA considers that the rule will help level the playing field for firms whose products and services actually represent a more sustainable choice for consumers.

From an oversight perspective, the rule provides the FCA with a specific ground upon which it can challenge those firms which it considers are making misleading or untrue claims about the sustainability of their products or services.

The guidance

Among examples of good and bad practice, the guidance provides certain clarifications around the scope of the anti-greenwashing rule. In particular, the FCA has clarified that the rule does not extend to sustainability-related claims that firms make about themselves generally, as opposed to their products or services. However, under the guidance, the FCA sets the expectation that a firm should still take into account any sustainability-related claims it makes about itself as a business as part of the 'representative picture' when considering the sustainability-related claims it intends to make about a particular product or service.

Despite providing some useful clarifications, some commentators have noted that the guidance focusses on finance products, particularly in the examples used. They also feel that the timing of the introduction of the anti-greenwashing rule has not given firms sufficient opportunity to ensure they are complying with the rule. In the guidance, the FCA has pushed back on this claim, stating that, for many firms, the introduction of the anti-greenwashing rule does not introduce a new requirement, as they should already be ensuring that their claims are 'fair, clear and not misleading' pursuant to existing rules in the FCA Handbook.

Implications for the insurance sector

At first glance, and in light of a focus on finance products in the FCA's guidance, the introduction of the anti-greenwashing rule might not seem immediately as relevant to firms within the insurance sector, although it is clear that the rule applies to all firms regulated by the FCA. In its advice to the European Commission on Greenwashing, EIOPA has provided some insurance-specific examples of potential greenwashing, such as, an insurer saying it will plant a tree for every life policy purchased but then still investing in fossil fuel.

However, in recent years the insurance sector has shown a marked interest in sustainability, likely in part in response to rising consumer interest in sustainable products. The availability of 'green' or 'sustainable' insurance products is on the rise, evidenced, for example, by the introduction of various motor insurance policies that provide motorists with the opportunity to offset their carbon emissions.

Firms are also paying close attention to their own sustainability credentials, issuing statements about commitments to climate change and sustainability targets more generally. Whilst claims about a firm's sustainability credentials are not caught by the anti-greenwashing rule directly, this plays into the wider focus on the credibility of sustainability-linked claims by other bodies (including the Competition & Markets Authority) as noted in the FCA's guidance.

Whilst the guidance does not speak specifically to the insurance sector, we can see from the broad scope of the anti-greenwashing rule, and the FCA's wider focus on sustainability and ESG, that efforts to introduce sustainable insurance products, and associated sustainability-related claims about those products, will be open to scrutiny by the FCA. Accordingly, firms should, as part of their wider governance frameworks, be introducing assessments of greenwashing risk, with particular focus on ensuring that any sustainability-related claims are considered carefully during the design process for a product or service.

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FCA and PRA publish Artificial Intelligence updates

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"The FCA states that its principle of proportionality informs the FCA's approach to AI, and allows firms flexibility to adapt and innovate."

On 22 February, the FCA published an update on its approach to artificial intelligence, and the PRA published a letter on the same topic. These were in response to the Government's pro-innovation strategy on AI. In this article, we briefly set out the details of these developments.

FCA update

The FCA makes clear that its approach is to identify and mitigate risks to its objectives, including from reliance on different technologies, such as AI, blockchain and the cloud, and the harms these could potentially create for consumers and financial markets. The FCA states that its principle of proportionality informs the FCA's approach to AI, and allows firms flexibility to adapt and innovate.

The paper sets out how the FCA's framework maps on to the Government's five key principles on the regulation of AI and explains that these are addressed by the FCA's existing regulation. The principles are: 1) safety, security, robustness; 2) appropriate transparency and explainability; 3) fairness; 4) accountability and governance; and 5) contestability and redress.

The paper also includes discussion of the FCA's own use of AI. For example, the Advanced Analytics unit is using AI to develop tools to protect consumers and markets, and the FCA has also set up a Synthetic Data Expert Group. The FCA has stated that it wishes to support the industry in developing AI surveillance tools for markets and is particularly interested in how AI can help identify more complex market abuse such as cross-market manipulation.

In the next 12 months, the FCA proposes to undertake the following:

- The priority is to build an in-depth understanding of how AI is deployed in UK financial markets, and diagnostic work is being undertaken in this area.
- New developments are being monitored such as the rapid rise of Large Language Models (LLMs) to ensure that any future regulatory adaptions are made when needed.
- The FCA will continue to collaborate with the Bank of England, the Payment Services Regulator, and international partners.
- The FCA is working with the Digital Regulation Cooperation Forum (DRCF) member regulators to deliver the pilot AI and Digital Hub, which allows innovators to obtain answers to complex

queries that span the regulatory remits of DRCF member regulators. The FCA also runs the Digital Sandbox to allow the testing of technology via synthetic data and the Regulatory Sandbox. In addition, it is assessing ways for new regulatory engagement, such as exploring changes to innovation services to enable the testing, design and governance of AI technologies in UK financial markets in an AI sandbox.

- The FCA has published a response to its Call for Input on the potential competition impacts from the data asymmetry between Big Tech and traditional financial services firms. One of the concerns was that asymmetry of data could have significant adverse implications for how competition develops in the financial services sector. The FCA has set out next steps including continuing to monitor Big Tech firms' activities and developing further proposals.

PRA report

The PRA also emphasises its technology-agnostic approach to regulation, and that the principle of proportionality informs its thinking on AI. Chapter 4 of DP5/22 (Artificial Intelligence and Machine Learning) sets out the current requirements and guidance most relevant to mitigating the risks of AI and machine learning. The PRA believes that its approach is consistent with the Government's framework.

In terms of work in this area, the PRA notes previous steps it has taken together with the FCA. It has explored four areas where further clarification of the regulatory framework could be beneficial that are relevant to this area: data management; model risk management; governance; and operational resilience and third-party risks. The PRA plans to run the third instalment of its "Machine learning in UK financial services survey" to ensure that its understanding of AI/machine learning remains up to date. Given the pace of innovation, it will undertake a deeper analysis of potential financial stability implications over the course of the year. Finally, following consultations with stakeholders, an AI consortium may be established.

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"Firms' actions from before the Duty was in force will be judged against the rules at the time, but closed products and services must be compliant with expectations on the price and value outcome"

FCA publishes Dear CEO letters on implementing the Consumer Duty for closed products and services

The implementation of the Consumer Duty is fast approaching for closed products and services: it will apply from 31 July 2024.

With this in mind, the FCA has recently sent a number of Dear CEO letters on the topic of implementing the Duty, including a letter addressed to the life insurance sector, and a letter to all firms outside the sectors that have specifically been addressed by other letters. It is important for all firms to review and have regard to these letters, which include some particular themes to consider.

Unsurprisingly, the letters remind firms that they must review closed products and services against all aspects of the Duty before 31 July 2024 and on an ongoing basis. The Duty does not apply to past actions, but rather to ongoing actions from 31 July in respect of closed products, such as communications in relation to those products. The products and services outcome will not apply in the same way to closed products and services, as there are no requirements regarding target markets or distribution strategies.

Drawing on its supervisory insights, the FCA flags five key themes that need to be considered. The life insurance letter notes that life insurers are likely to be particularly affected due to their large books of closed products. The themes in the letters are as follows:

Gaps in firms' customer data

Firms must address material gaps for closed products and services and be able to evidence that they are acting to deliver good outcomes. Closed products might be older, and the data incomplete, for example due to challenges with complex legacy systems. For life insurers, gaps in policyholder data might make it difficult to understand the needs of groups of customers and firms should improve the core data and flow of data into monitoring. There might be a need for longer-term strategic investment.

Fair value

Firms' actions from before the Duty was in force will be judged against the rules at the time, but closed products and services must be compliant with expectations on the price and value outcome. The fair value framework must be applied consistently to open and closed products or different approaches justified, and the expected total price to be paid by retail customers must be assessed and prove reasonable relative to potential benefits.

Treatment of customers with characteristics of vulnerability

Firms must be aware that the challenges of closed products and services can create a particular risk of harm to vulnerable customers, such as data gaps, age and complexity of products and the fact consumers' circumstances and needs change over time. Life insurance customers can face challenges in making the right decisions due to the long-term nature of the policies.

Gone-away or disengaged consumers

Firms must consider how they can support and communicate with these customers. This is a particular challenge for life insurance and firms must challenge themselves to undertake appropriate tracing, and consider what can be done to increase the success of exercises where minimal customers have responded. The FCA states that, where policies are worth small amounts and tracing might have a disproportionate impact on other customers, reasonable steps must still be taken, but this additional consideration will be taken into account.

Vested contractual rights

Firms are not expected to give up vested contractual rights, although they are free to do so. These include rights to which a firm already has a legal entitlement, such as annual fees that are due, or payments falling due if a specified event takes place, such as exit charges. To decide whether a right is a vested right, the firm must consider the contract length and whether either party can freely terminate – if a customer can terminate without an exit charge, then firms have no more than an expectation of the contract continuing and the payment of future charges is not a vested right.

If a firm does not wish to give up a vested right, it should consider alternative ways to prevent or manage harms, such as providing greater flexibility on how customers can engage with a product or helping the customer switch to a new product without the same issues.

Conclusion

No doubt many firms will be well underway with their review of their closed products and services, but it is important to consider the issues outlined in these letters, and to be ready by the deadline. We have been assisting firms with implementing and complying with the Duty, and can advise on the actions which should be taken to meet the impending deadline for compliance.

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FCA proposals for publication of investigations have merit in some circumstances but there are serious concerns

The Financial Conduct Authority's (FCA's) recent proposals to publish details, including the firm name, when it opens an investigation, have met with a huge amount of commentary, much of it highly critical; including from politicians.

Plainly the rights of the public must be weighed against the rights of the firms. Most would agree that the operators of an illegal Ponzi scheme should be exposed to prevent further loss to prospective investors.

On the other hand firms very reasonably worry that their reputations will be tarnished by the publication of the fact of an FCA investigation into them and there is the basic principle that everyone is innocent until proven guilty. This is compounded by the fact that the FCA closes the vast majority of investigations taking no action at all. Firms worry their reputations will be unfairly tarnished and suffer serious detriment as a consequence, in connection with an investigation which ultimately goes nowhere.

Against this backdrop the FCA needs to do more to assure firms that publication will only take place where circumstances absolutely require it (and in most cases this will not be so). In this article we discuss the proposals, recent developments, and our thoughts in more detail.

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DISPUTES

Court of Appeal construes a W&I policy

***Project Angel Bidco v Axis and others* concerned a buyer-side warranty & indemnity policy, underwritten on behalf of Project Angel Bidco Ltd (PABL).**

A W&I policy allows a buyer of a company to insure the risk that the target is not in the state warranted by the sellers, and so worth less than the purchase price. The case is a useful example of how the courts will interpret inconsistent aspects of policy wording, particularly in a W&I context. It is also a reminder that, whatever the position according to the warranty spreadsheets attached to the policy, the coverage will be subject to the full terms and conditions of the policy, including any exclusions.

More information is available here.

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Court of Appeal rules out COVID-19 cover where policy required damage

The Court of Appeal has handed down judgment in *Bellini v Brit*. This case joins the growing collection of decisions interpreting business interruption cover in the context of the COVID-19 pandemic.

It follows the High Court decision which held there was no cover in the absence of physical damage, on the basis of this particular wording. The Claimant appealed on the grounds that there was a clear mistake in the wording of the disease clause warranting the application of the "correction of mistakes by construction" doctrine established in East v Pantiles (Plant Hire) Ltd. The Court of Appeal rejected the appeal.

In this article, we consider the judgment further.

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