

Hello. I'm Amanda Hale from Citi's Global Trustee and Fiduciary Services Regulatory team.

And joining me to provide an update on the latest regulatory highlights are my colleagues,

Andrew Newson and Matthew Cherrill.

So, what do firms need to be aware of this month?

ANDY: Starting in the US, the SEC announced adoption of amendments to Regulation S-P to modernise and enhance the rules that govern the treatment of consumers' non-public personal information by certain financial institutions.

The amendments update the rules' requirements for broker-dealers (including funding portals), investment companies, registered investment advisers, and transfer agents (collectively, "covered institutions") to address the expanded use of technology and corresponding risks that have emerged since the SEC originally adopted Regulation S-P in 2000.

MANDY: And what do the SEC's amendments cover?

ANDY: They require covered institutions to develop, implement, and maintain written policies and procedures for an incident response program that is reasonably designed to detect, respond to, and recover from unauthorised access to, or use of, customer information.

Also requiring that the response program include procedures for, with certain limited exceptions, covered institutions to provide notice to individuals whose sensitive customer information was or is reasonably likely to have been accessed or used without authorisation.

MANDY: So, how quickly must incident response notifications be made?

ANDY: A covered institution must provide notice as soon as practicable, but not later than 30 days, after becoming aware that an incident involving unauthorised access to, or use of customer information has occurred or is reasonably likely to have occurred.

The SEC says that the notice must include details about the incident, the breached data, and how affected individuals can respond to the breach to protect themselves.

And in terms of timing, the amendments will become effective 60 days after publication in the Federal Register. Larger entities will have 18 months after the date of publication in the Federal Register to comply with the amendments, and smaller entities will have 24 months.

MANDY: Matt, what's the latest in Europe?

MATT: ESMA has issued a Statement providing initial guidance to firms using Artificial Intelligence when providing investment services to retail clients.

ESMA says that when using AI, it expects firms to comply with relevant MiFID requirements, particularly when it comes to organisational aspects, conduct of business, and their regulatory obligation to act in the best interest of the client.

ESMA says that potential uses of AI by investment firms under MiFID include: customer support, fraud detection, risk management, compliance, and support to firms in the provision of investment advice and portfolio management.

MANDY: Is anything else set out in the ESMA Statement?

MATT: ESMA states that, although AI offers potential benefits to firms and clients, it also poses inherent risks, such as:

- The robustness or reliability of the output, quality of training data, and algorithmic bias leading to outputs that are factually incorrect even if they sound realistic and accurate.
- A lack of transparency and explainability meaning an AI's decision-making processes are not understandable.
- Lack of accountability and oversight, where service providers and clients might over-rely on AI for decision-making, neglecting the importance of human judgment.
- And privacy and security concerns linked to the collection, storage, and processing of the large amount of data needed by AI systems.

ANDY: Mandy, staying in Europe but turning to ESG in the funds space, we've had some developments?

MANDY: Yes, ESMA published its final report containing Guidelines on funds' names using ESG or sustainability-related terms.

These outline minimum requirements that a fund should meet before using any ESG or sustainability-related terms in their fund names.

The objective of the Guidelines has been described by ESMA as one of ensuring that investors are protected against unsubstantiated or exaggerated sustainability claims in fund names, whilst also providing asset managers with clear and measurable criteria to assess their ability to use ESG or sustainability-related terms in fund names.

ANDY: And what are the specific criteria that asset managers need to be aware of?

MANDY: That when using six ESG related terms such as: 'transition', 'environmental', 'social', 'governance', 'impact' and 'sustainability' in a fund's name, certain categories must be complied with:

- That a minimum threshold of 80% of investments should be used to meet environmental, social characteristics, or sustainable investment objectives under SFDR.
- A requirement for these funds to make minimum exclusions based on criteria found in either the Paris Aligned Benchmark, for most sustainability-related terms, or the Climate Transition Benchmark for transition-related terms.
- Plus, some other additional requirements, specific to the term used.

It's also worth noting that funds using terms from more than one of the six ESG terms must fulfil all requirements on a cumulative basis.

Also, that funds which only disclose on sustainability risks under Article 6 of SFDR may not use any ESG or sustainability related terms in their fund names.

ANDY: And when do the Guidelines take effect from?

MANDY: Once the Guidelines are translated, they will be published on ESMA's website and will apply three months after publication.

But asset managers should also be aware of some specific transition provisions.

- For funds existing before the application date, they will have six months to comply from that date.
- Whereas for new funds created after the application date, the Guidelines apply immediately.

ANDY: And Mandy, as we ticked into June, the European Supervisory Authorities (ESAs) also published their respective final reports on greenwashing.

MANDY: Yes, each authority provides a stock take of the current supervisory response to greenwashing risks under their remit and notes that NCAs are already taking steps around the supervision of sustainability-related claims.

In addition, the Authorities look at how sustainability-related supervision can be gradually enhanced in the coming years.

ANDY: Looking at the ESMA report covering investment managers, what does that tell us?

MANDY: It indicates priority actions enabling supervisors to better mitigate greenwashing risks:

- National Competent Authorities are expected to gradually deepen their critical scrutiny of sustainability-related claims.
- ESMA will continue to support the monitoring of greenwashing risks, including the deployment of tech-based supervision tools, and capacity building, and may produce additional guidance for market participants and supervisors in high-risk areas of greenwashing.

- And the European Commission is invited to reinforce NCAs' and ESMA's mandates in certain areas, such as for benchmarks, and make sure all NCAs have the powers to promote retail investors' financial education.

ANDY: Matt, turning to the UK and operational resilience, what's the latest?

MATT: On the 28th of May the FCA published a new webpage - Operational resilience: insights and observations for firms - aimed at making sure firms are ready to comply with its operational resilience rules, as they approach the end of the FCA's transitional period on 31 March 2025.

The FCA says firms should use its observations to help review their approach to the rules.

ANDY: And who is this aimed at?

MATT:

Amongst others, the rules apply to:

- PRA-designated investment firms.
- Banks and building societies.
- And enhanced scope SM&CR firms.

MANDY: What areas are covered by the FCA's observations?

MATT: There are quite a few, but they include:

- Identifying important business services and keeping them under review.
- Setting, and regularly reviewing, impact tolerances for each important business service.
- Identifying and documenting the people, processes, technology, facilities, and information necessary to deliver each of its important business services, including third parties.
- Developing and keeping up-to-date testing plans that detail how a firm can remain within impact tolerances for each of its important business services. And
- Mapping and scenario testing that should identify any vulnerabilities as a result of severe but plausible scenarios.

The FCA says it expects all firms to be resilient and provide services for their customers when needed.

MANDY: If you would like to learn some more about the topics we discussed today, as well as other regulatory developments, you can follow the relevant links in our Bite-Sized publication.