ALLEN & OVERY

Financial Services Horizon Report

2022

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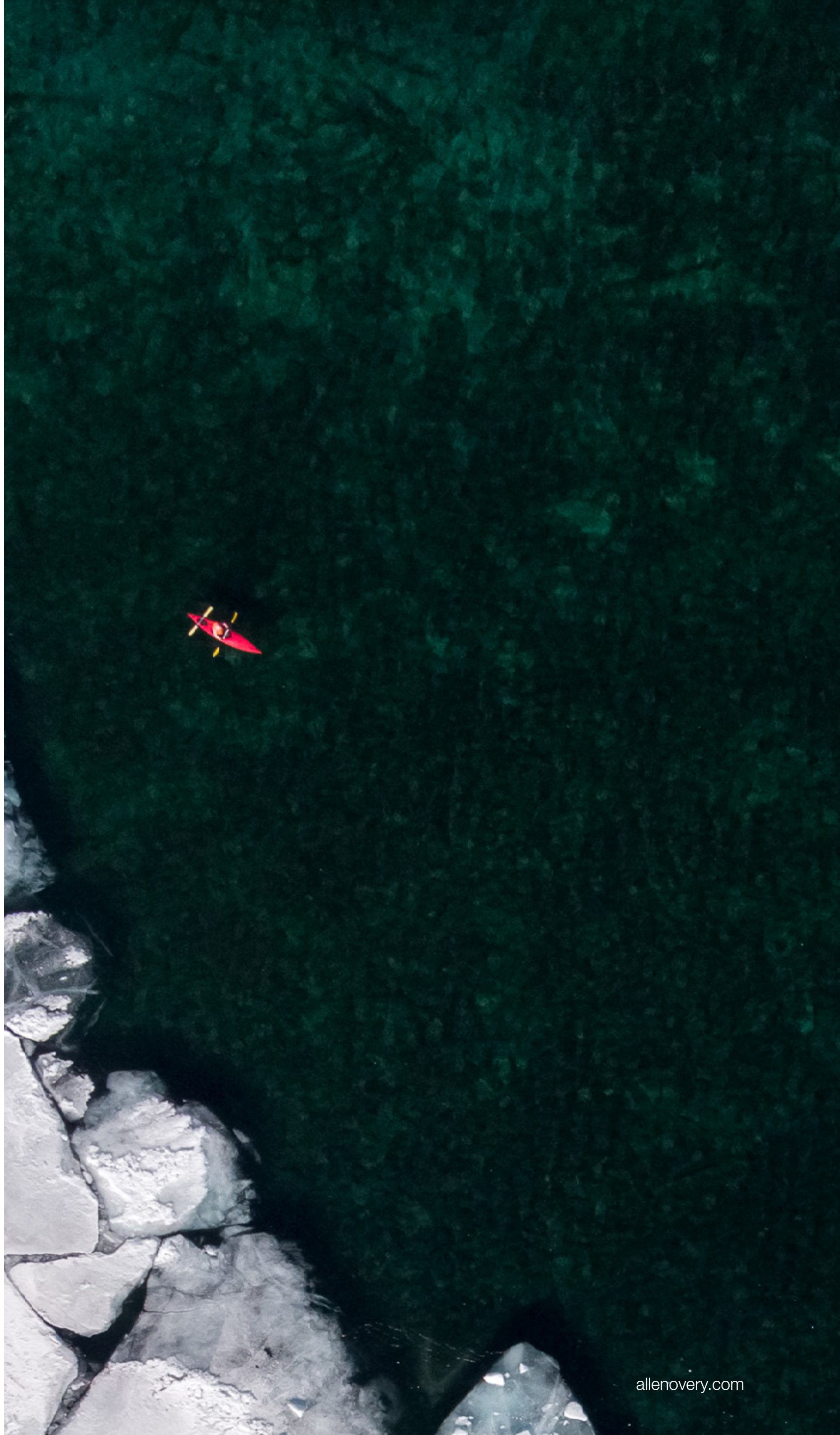
Overview of the year ahead

2022 looks set to be another year dominated by regulatory reform for financial services firms. This document considers a number of key wholesale market developments including the latest on the MiFID Review and other financial markets regulation initiatives, resolvability assessments and operational resilience, the Banking Package, updates in relation to the regulation of digital assets and the ongoing changes to the UK regulatory framework in light of Brexit.

Please note that the document does not seek to cover all regulatory developments planned for 2022 and does not look at changes planned for the insurance, pensions or payments sectors.

Starting with a bang

The dawn of 2022 heralded a new era of prudential regulation for FCA-authorised investment firms, the "IFPR". The IFPR aims to streamline and simplify the prudential requirements for MiFID investment firms prudentially regulated in the UK by the FCA. It has been designed to achieve the same overall outcomes as the EU's Investment Firm Regulation and Investment Firm Directive, which were implemented on 26 June 2021. Investment firms are subject for the first time to liquidity requirements across the board. The levels of initial capital required for authorisation have been updated and there is a new methodology for calculating capital requirements, the K factor approach. Investment firms are also subject to new remuneration and disclosure requirements. But the devil is in the detail and FCA-authorised investment firms will churn through their new ICARA, remuneration, and reporting and disclosure processes and remain vigilant to the shaping of FCA expectations throughout 2022.



The new year also brought in the UK's implementation of a number of Basel III standards. This has been done pursuant to new powers granted to the PRA by the Financial Services Act 2021 to make "CRR rules" to replace provisions of UK CRR revoked by HM Treasury that need to be updated to reflect the latest Basel standards. Key areas of change for UK firms include revised rules for risk-weighting funds, a revised methodology for valuing and risk-weighting derivatives and long settlement transactions, changes to the calibration of the leverage ratio and implementation of a binding net stable funding ratio. There is more to come in 2022 as the UK looks to implement the final Basel III standards.

The Brexit legacy – divergence & UK regulatory reform

The effect of the Brexit onshoring programme has been to leave the UK with a domesticated version of the EU rulebook. In a number of respects that rulebook is not fit for purpose: it is inflexible, being largely based in legislation, not rules; it reflects the needs of EU, not UK, markets; and it includes a number of areas in which the UK's policy objectives diverge from those of the EU.

Movements towards reform of the framework are progressing at a number of different levels. To reform the UK regulatory system to make it more fit for purpose, the UK government launched a consultation in 2020 on the Future Regulatory Framework. This contemplates the medium-term migration of EU legislation into the regulators' rulebooks, subject to the oversight of the government. Given the scale of the EU legislation in place, this exercise is going to take a number of years. In the meantime, there have been targeted areas in which the UK authorities have consulted on and/or implemented changes which diverge from the EU position. The former include in areas of the Markets in Financial Instruments Directive and Regulation (most of which are also under review in Europe); the latter include the implementation of the remaining amendments to the prudential framework under the Capital Requirements Regulation 2.

UK-regulated firms were largely resigned to, and prepared for, the loss of their single market rights; but operationalising divergence will still continue to give rise to short- and medium-term challenges for many. Divergence poses challenges for internationally active firms in particular: starting from the perspective of an integrated set of regulatory requirements across the EU and UK, points of divergence – both as a result of UK and EU changes – require that firms implement operational changes to reflect the different frameworks. Firms will need to get their heads around how they approach and manage divergence during the course of 2022.

Timeline

Click on a theme (▶) to read more.

2022

Early 2022
Recommendations from the review panel submitted to HM Treasury (UK)
▶ UK ring-fencing regime

2022
UK government to consult on proposals following its Call for Input of the Future UK Fund Regime (UK)
▶ Future UK Fund Regime

Legislation to extend the SMCR to FMIs may be published (UK)
▶ Individual accountability

EU political negotiation of Banking Package 2021
▶ Prudential
▶ Recovery and resolution

EU legislators to finalise legislative proposals implementing the MiFID/MiFIR Review (EU)
▶ MiFID/MiFIR

EU to adopt package of four AML legislative proposals (EU)
▶ AML/Financial crime

EU political negotiation of Banking Package 2021
▶ Digital assets
▶ Operational resilience

Joint UK regulators' DP on oversight of critical third parties anticipated
▶ Operational resilience

H1

FCA/PRA consultation paper on diversity in financial services expected, with a policy statement expected in H2 2022 (UK)
▶ Sustainability

PRA expected to publish initial CP on simplified prudential regime for non-systemic banks
▶ Prudential

PRA CP on outsourcing and third-party risk management (register) anticipated
▶ Outsourcing and operational resilience

PRA CP on operational resilience incident reporting anticipated
▶ Operational resilience

Q1

ESMA final report expected (EU)
▶ Financial promotions and marketing

FCA consultation paper on high-risk investments and firms approving financial promotions expected (UK)
▶ Financial promotions and marketing

FCA consultation on the potential for widening the distribution of the LTAF to a broader range of retail investors (UK)
▶ Future UK Fund Regime

HM Treasury expected to publish final proposals flowing from the Wholesale Markets Review and the FCA to consult on its related changes (UK)
▶ MiFID/MiFIR

January

FCA expects to publish policy statement setting out changes that (among other things) clarify scope and address concerns with performance scenarios and summary risk indicators (UK)
▶ PRIIPs

31 January 2022
ESAs final joint report on the Digital Finance Strategy expected (EU)
▶ FinTech/Digital Assets

February

Cash-penalty regime begins to apply (EU)
▶ CSDR

FCA REP-CRIM reporting obligations apply to MiFID-related activities as well as cryptoasset businesses (UK)
▶ AML/Financial crime

28 February 2022
MiFID II "quick fix" changes apply (EU)
▶ MiFID/MiFIR

12 February 2022
Application date for provisions in EU CCP Recovery and Resolution Regulation concerning recovery plans
▶ Recovery and resolution

Financial Services Future Regulatory Framework Review consultation closes (UK)
▶ Perimeter/regulated activities

March

1 March 2022
Changes to the FCA's MiFID II inducement rules on research start to apply (UK)
▶ MiFID/MiFIR

31 March 2022
Temporary transitional directions cease to apply (UK)
▶ Brexit

31 March 2022
UK's revised operational resilience framework starts to apply (transitional period for impact tolerances to 2025)
▶ Operational resilience

31 March 2022
PRA's new guidance on outsourcing and third-party risk management applies
▶ Outsourcing

April

PRA PS on trading activity wind down anticipated
▶ Recovery and resolution

HM Treasury is expecting to lay secondary legislation on amendments to the MLRs (UK)
▶ AML/Financial crime

FCA expected to publish a consultation paper on the draft SDR rules and the new product labelling and classification regime (UK)
▶ Sustainability

Q2

FCA expected to publish a policy statement on the Appointed Representative regime (UK)
▶ Perimeter/regulated activities

ESAs to due to deliver their advice to the Commission (EU)
▶ PRIIPs

30 April 2022
EBA guidelines on sound remuneration and internal governance enter into force
▶ Prudential

June

First public disclosures under the UK's Resolvability Assessment Framework
▶ Recovery and resolution

26 June 2022
HM Treasury to publish a report on the review of the MLRs and OPBAS regulations (UK)
▶ AML/Financial crime

Mid-2022

Law Commission consultation expected on the property status of digital assets (UK)
▶ FinTech/Digital Assets

Commission expected to publish its strategy on retail investments (EU)
▶ MiFID/MiFIR

30 June 2022
Temporary equivalence decision for UK CCPs expires (EU)
▶ Brexit

28 June 2022
Article 449A CRR applies in relation to ESG-risk reporting (EU)
▶ Sustainability

H2

HM Treasury and PRA consultations on implementation of final Basel III standards anticipated
▶ Prudential

PRA CP on changes to operational continuity in resolution reporting possible
▶ Operational resilience
▶ Recovery and resolution

Political agreement on the legislative proposals flowing from the AIFMD Review expected (EU)
▶ AIFMD Review

July

EU review of crisis management and deposit insurance framework
▶ Recovery and resolution

August

12 August 2022
EU CCP Recovery and Resolution Regulation applies generally
▶ Recovery and resolution

1 August 2022
ESG changes to MiFID II, AIFMD and UCITS integrating sustainability into organisational requirements begin to apply (EU)
▶ Sustainability

BoE/HM Treasury/FCA policy statement on EMIR reporting standards expected (UK)
▶ EMIR

New PRIIPs RTS expected to apply (EU)
▶ PRIIPs

September

1 September 2022
Initial margin requirement for phase 6 counterparties (UK and EU)
▶ EMIR

Q4

Commission expected to adopt strategy on retail investments
▶ MiFID/MiFIR

November

22 November 2022
ESG changes to MiFID II integrating sustainability into product governance requirements start to apply (EU)
▶ Sustainability

End 2022

EC to submit legislative proposal following review of macro-prudential provisions in CRDIV
▶ Prudential

31 December 2022
First annual art. 449A disclosure required in relation to ESG risks (subject to transitional period) (EU)
▶ Sustainability

December

26 December 2022
Article 53 IFR applies in relation to ESG risk reporting (EU)
▶ Sustainability

Cross-sector

Sustainability (including diversity)

EU

SFDR

In March 2021, firms subject to the SFDR were required to make certain pre-contractual and website disclosures, which could be made in line with the SFDR Level 1 requirements. The principal adverse impacts (PAI) regime operates on an "opt-in" or "opt-out" basis but from 30 June 2021, the ability to "opt out" fell away for larger firms – eg firms with more than 500 employees. From 1 January 2022, periodic reports in relation to Articles 8 and 9 SFDR products will need to comply with applicable SFDR requirements and will be due at the point at which the annual report would otherwise be published in 2022.

The SFDR RTS were initially expected to come into effect on 1 January 2022. In July 2021, the Commission announced that the SFDR RTS would be adopted in a single delegated act – with an expected application date of 1 July 2022. In October 2021, the European Supervisory Authorities (ESAs) submitted draft RTS on the content and presentation of sustainability disclosures under Articles 8(4), 9(6) and 11(5) of the SFDR. On 29 November, the EU Commission published a letter to the EU Parliament and EU Council confirming that the application of the RTS will be deferred to 1 January 2023. The Letter also noted that, in view of the further deferral of the application of the RTS, the Commission envisages that financial market participants which publish a statement on their due diligence policies on PAIs of investment decisions on sustainability factors will have to comply with the related disclosure requirements on PAIs laid down in the RTS for the first time by 30 June 2023. The Letter states that the first reference period for this reporting under the RTS will be 1 January 2022 to 31 December 2022, a period falling prior to the new effective date of the RTS.

Publication of the final draft RTS, which consolidates the SFDR and Taxonomy disclosure requirements, is expected in January 2022 and it will then be subject to an objection period with the EU Council and the EU Parliament.

ESG changes to MiFID II, AIFMD, UCITS and insurance directives

During 2021, the European Commission finalised its proposed ESG-related changes to key sectoral legislation (namely, MiFID II, AIFMD, UCITS and insurance directives) to build ESG considerations into frameworks governing suitability assessments, conflicts of interest, risk management and product governance. In part, these changes are intended to "mainstream" the consideration of ESG risks by relevant financial services firms, contributing to a push to put "sustainability considerations" at the heart of the financial system. Equally importantly, they are intended to "turbo charge" the European Commission's efforts to redirect private capital into efforts to "green" the EU, plus avoid greenwashing. The majority of the changes enter into force at the start of August 2022 with the MiFID II product governance changes coming into force in November 2022.

The MiFID II changes are intended to fit together with SFDR although the changes apply more broadly – with impacts for MiFID investment firms and banks that manufacture and distribute MiFID products. There are three key strands to the changes which apply differently to different types of firms. The first strand sets out the new general ESG requirements, the second looks at revised product governance requirements and the third sets out a new regime relating to the sustainability preferences of retail and institutional clients. For a detailed review of the new requirements, please refer to our bulletin which can be accessed here.

EU

Prudential

Large institutions which have securities admitted to trading on a regulated market will need to disclose information on ESG risks under new requirements introduced under CRR 2, which will apply from June 2022 on an annual basis during the first year and bi-annually afterwards. A similar requirement applies for investment firms subject to the new EU prudential framework for investment firms. The Investment Firms Regulation requires large firms to disclose ESG risks from December 2022.

Following the EBA's report on management and supervision of ESG risks for credit institutions and investment firms in June 2021 and the European Commission's renewed Strategy in July, October 2021 saw the Commission adopt legislative proposals for a review of CRRII and CRDV – these are discussed in more detail below. While the package primarily aims at ensuring a stronger resilience of EU banks to potential future economic shocks by finalising the implementation of the Basel III rules, it is also intended to contribute to the transition to climate neutrality. To do this, requirements in relation to the following areas are proposed:

– The introduction of uniform definitions for types of ESG risk, so that standardised and clear definitions can lead to comparable measurement and assessment of risk.

– A requirement that business strategies, processes and governance frameworks must include consideration of ESG risks, with the time horizon for strategic planning to be extended to at least ten years when incorporating ESG-risk considerations into business strategies. EBA guidelines will be developed to specify the criteria for the assessment of ESG risks.

– The management body will be required to develop and sign-off on specific plans and quantifiable targets to monitor and address the risks arising from the misalignment of the business model and strategy of the institutions with the relevant EU policy objectives or broader ESG transition trends.

– Disclosure of information on exposures to ESG risks is proposed to be included in the supervisory reporting of all institutions (not just large institutions, as required by CRR II).

– And finally, ESG risk will be incorporated into supervisory review process.

In addition to the above, the EBA is mandated under CRR (as amended by CRR2) to produce a report on whether a dedicated prudential treatment of ESG exposures should be developed, or whether the treatment of ESG risks can be factored into the existing capital requirements framework. As part of its Renewed Sustainable Finance Strategy, the Commission confirmed that this review would be brought forward from 2025 to 2023.

It is also worth noting that during 2022, the ECB will conduct a thematic review of banks' climate and environment risk management practices and a supervisory stress test as it gradually integrates these risks into its supervisory review and evaluation process methodology.

For more information on initiatives such as Taxonomy-alignment entity reporting and the proposed Corporate Sustainability Reporting Directive, please refer to our dedicated webpages which can be found here.

UK

In the context of COP26, the UK took the opportunity to issue an array of documents and proposals, hoping to establish its credentials (post Brexit) as a leading light on ESG and climate change, and a rival to the EU, which is already well down the track with its own ambitious proposals. This included a proposed new regime on transition planning (including mandatory disclosures), the UK's new Sustainability Disclosure Requirements (SDR), proposals for a product labelling and classification regime, bringing ESG ratings into the scope of FCA regulation, and introducing a regime similar to that being made for ESG to MiFID II as regards sustainability preferences and financial advisers. For a detailed overview of these proposals and an outline on expected timing, please refer to our bulletin which can be accessed here.

In the context of prudential regulation, 2022 will see the PRA switch its supervisory approach on its climate-related supervisory expectations from one of assessing implementation to actively supervising against them. The PRA has acknowledged that challenges arising from issues such as data gaps persist but that firms should use their judgement, expertise, and the tools available to them to demonstrate understanding and management of the risks posed by climate change to their businesses. The regulator acknowledges that this approach will then need to evolve, as industry-wide understanding of climate-related financial risks, data, tools, and best practice continue to develop. As climate change becomes part of the core supervisory approach, firms should expect to demonstrate effective management of climate-related financial risks through regular supervisory engagements. Where progress is insufficient, the PRA has made clear that it will request clear plans and, where appropriate, consider exercising its powers and use of its wider supervisory toolkit. For example, from the beginning of 2022, that might include the use of risk management and governance-related capital scalars or capital add-ons and the appointment of a Skilled Persons under Section 166 of the Financial Services and Markets Act 2000. By the end of 2022, it is expected that the PRA will set out its views on whether changes to the capital requirements are required to address climate-related financial risks.

In July 2021, the PRA, FCA and BoE published a joint discussion paper seeking views on regulatory plans to improve diversity and inclusion in financial services. The PRA and the FCA will consult on more detailed proposals in H1 2022 with a policy statement expected in H2 2022.

Brexit

EU

In September 2020, the European Commission adopted a time-limited decision to give financial market participants 18 months from the end of the Brexit transition period to reduce their exposure to UK central counterparties. The decision determined that the regulatory framework applicable to central counterparties (CCPs) in the UK was equivalent to EMIR. ESMA subsequently announced that three UK CCPs would be recognised as third country CCPs eligible to provide their services in the EU, after the end of the transition period. The current equivalence decision applies until 30 June 2022.

On 10 November 2021, the European Commission published a statement by Mairead McGuinness, European Commissioner for Financial Services, Financial Stability, and Capital Markets Union, announcing the Commission's proposed way forward for central clearing. The Commission remains of the view that over-reliance on UK-based CCPs for some clearing activities is a source of financial-stability risk in the medium term. It will therefore pursue its work to develop the capacity of EU-based CCPs as a means to reduce such over-reliance. However, to address possible short-term financial-stability risk, the Commission will propose, in early 2022, extending equivalence for UK-based CCPs. It is expected that the extension of equivalence will be long enough to allow the Commission to revise the EU CCP supervisory system.

UK

While the onshoring of EU law (and the related corrections of "deficiencies") was only intended to provide a functioning statute book and ruleset from the end of the transition period with no policy amendments, the onshoring process did generate a host of potentially material changes for financial market participants – for example changes to risk weights of exposures of UK banks to EU banks.

To help firms adapt to their new requirements, HM Treasury gave UK financial regulators the power to make directions which amended the effect of the onshored EU legislative ruleset in order to provide temporary relief from changes to pre-exit practice. Each of the regulators exercised its transitional powers broadly. These directions provide for a "standstill" of relevant obligations – in broad terms, obligations which begin to apply or apply differently, in relation to which the regulator has responsibility for supervising or ensuring compliance. Each transitional [direction] contained a list of exclusions – these were obligations which the regulators expressly did not "standstill". The regulators expected that firms would use the duration of the standstill to prepare for full compliance with changes to UK regulatory obligations. Full compliance with onshored regulatory obligations is required by 31 March 2022.

Perimeter/regulated activities

Future UK Regulatory Framework

The Future Regulatory Framework (FRF) Review was announced by the then Chancellor of the Exchequer at Mansion House on 20 June 2019, with the objective of reviewing the UK's financial services regulatory framework to ensure it is fit for the future. The FRF Review represents an important opportunity, following Brexit, to ensure that the financial services regulatory framework reflects the UK's new position and supports delivery of the government's vision for the financial services sector. It also complements a number of further reviews and initiatives that are underway on specific areas of financial services regulation intended to support and encourage growth in the UK as a global financial services hub, while maintaining high regulatory standards. These include the government's reviews looking into the prudential regime for insurers, wholesale capital markets and the UK funds regime.

The government published an initial consultation looking at how to adapt the regulatory approach to meet the specific needs of the UK back in October 2020. On 9 November 2021, a second consultation was published which sets out the government's response to the feedback received on the previous consultation and sets out a series of proposals for how the government intends to take forward its approach to the FRF Review. The consultation runs until February 2022 and further proposals are expected during the course of 2022.

Review of the Appointed Representatives regime

On 3 December 2021, the FCA published a consultation paper on policy proposals to enhance its rules for principals with Appointed Representatives (ARs) with the aim of reducing potential harm across the sectors where they operate. The FCA's proposals require principals to provide additional (and more timely) information on their ARs and how these are overseen, and also clarify and strengthen the responsibilities and expectations of principals. A policy statement is planned for Q2 2022.

On the same day, HM Treasury launched a call for evidence seeking feedback on how market participants use the AR regime, how effectively the regime works in practice and what potential challenges exist to the safe operation of the regime plus a call for suggestions on possible future reforms that might be considered to address those challenges. The consultation closes on 3 March 2022.

Financial promotions and marketing

In July 2020 the government published a consultation with proposals to establish a regulatory "gateway", which a firm must pass through before it is able to approve the financial promotions of unauthorised firms. In June 2021, the UK government published its response to the consultation and outlined its intention to establish the regulatory gateway by restricting the approval of the financial promotions of unauthorised firms through the imposition of a specific financial promotion requirement on all new and existing authorised persons. An existing authorised firm wishing to undertake approval of financial promotions would then need to apply to the FCA to have this requirement varied or cancelled. A firm applying for authorisation would be able to specify whether it would like to have the financial promotion requirement varied or cancelled as part of the broader application process.

In April 2021 the FCA published a discussion paper titled "Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions". The discussion paper examined several possible changes to the FCA's financial promotion rules including the classification of high-risk investments, the segmentation of the high-risk investment market and the role of authorised persons who approve financial promotions. The FCA intends to publish a consultation paper with specific proposals early in 2022.

In December 2021, the UK government published a consultation paper which proposes changes to the regime which gives high-net worth individuals and sophisticated investors an exemption from restrictions on financial promotions. The proposed reforms are aimed at: (i) ensuring that thresholds for exempt investors are calibrated to reflect investors' experience or their ability to absorb losses; (ii) reducing the risk that the exemptions are used for promotions to investors who do not meet the conditions; and (iii) ensuring that, where exemptions are used, investors understand the regulatory protections they are losing and are able to take responsibility for their investment decisions. The consultation is open until 9 March 2022.

The final item related to financial promotions covers cryptoassets. In July 2020, the government consulted on a proposal to bring certain cryptoassets into the scope of financial promotions regulations. The Regulatory Initiatives Grid had suggested that HM Treasury would publish the response to the consultation in Q4 2021 but this timing appears to have slipped.

Individual accountability

In July 2021, HM Treasury published a consultation paper proposing an extension of the SMCR to financial market infrastructures (FMIs). The proposed regime would closely mirror the existing SMCR for other parts of the financial services sector and would give the BoE, as FMI supervisor, new rule-making, supervisory and enforcement powers analogous to those which the FCA and the PRA have in respect of the existing SMCR. The existing SMCR would be modified to recognise the fact that FMIs are not "authorised persons" within the FSMA meaning of the term. The consultation closed on 22 October 2021 and HM Treasury intends to legislate for the new regime when parliamentary time allows, possibly during 2022.

In October 2021, the FCA published its 2020/21 perimeter report which referred to extending the SMCR to the payments and e-money sector, and recognised investment exchanges and credit ratings agencies. The FCA noted that it would continue to work with HM Treasury in relation to the possible extension of the SMCR.

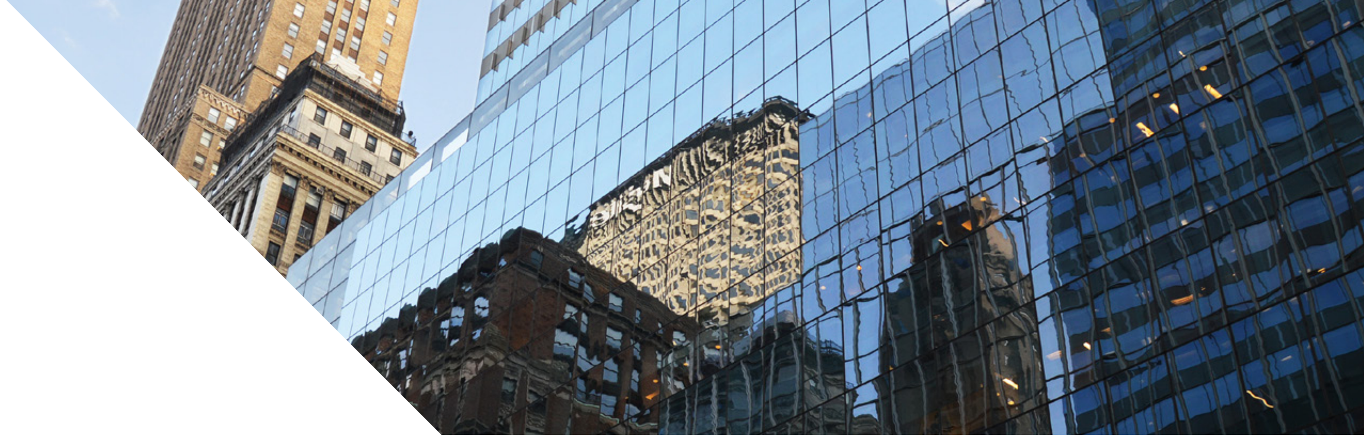
The FCA and HM Treasury are also considering extending the SMCR to ARs – this is covered in the consultation and call for evidence discussed above.

UK ring-fencing regime

As part of the required review of the operation of the UK ring-fencing regime, the panel appointed by HM Treasury published a call for evidence (in April 2021) which sought views on a range of issues including the impact of the regime on customers, competition and competitiveness and the operation of the regime as a whole. The Regulatory Initiatives Grid published in November 2021 states that the panel will submit a report with its recommendations to HM Treasury following the review in early 2022.

Banks and bank regulation

Prudential



UK

New regimes

The new year marked the commencement of a number of new prudential standards in the UK, including the implementation of those aspects of Basel III that formed part of the EU's Banking Reform Package of 2019 but which did not apply at the end of the transition period and were therefore not onshored. In particular, the PRA has implemented into its Rulebook updated provisions on the application of prudential requirements on a solo and consolidated basis, domestic liquidity sub-groups, credit risk and counterparty credit risk, interest rate risk, leverage ratio, large exposures and liquidity. The fourth regulatory initiatives grid indicates that HM Treasury and the PRA anticipate consulting on provisions to implement the final Basel III standards in H2 2022. Proposals to implement the final Basel III standards in the EU have already been published (see Banking Package 2021, below).

On 15 December, the PRA published feedback on its Discussion Paper 1/21, published in April 2021 and which explored options for developing a "strong and simple" prudential framework for PRA-regulated banks and building societies that are neither systemically important nor internationally active. Further consultation papers will follow during 2022 and/or 2023.

EU

Banking Package 2021/CRDVI

In the EU, a focus for industry will be the progress of the EC's Banking Package 2021 which proposes numerous further amendments to the Capital Requirements Regulation (CRR) and fourth Capital Requirements Directive (CRDIV), as well as to the Bank Recovery and Resolution Directive (BRRD). While the majority of these proposals are not anticipated to enter into force until 2025, some of the proposals are particularly contentious and will be the subject of much scrutiny throughout 2022. Please see our bulletin for further information on the proposals.

Recovery and resolution

In both the UK and EU, end-state MREL standards began to apply on 1 January for G-SIIs and top-tier banks.

EU

The EC's Banking Package 2021 contains a number of proposed changes to the EU's bank resolution framework. These proposals relate specifically to the indirect subscription of instruments eligible for internal MREL, further aligning the treatment of global systemically important institution groups with a multiple point of entry resolution strategy with the treatment outlined in the FSB's international Total Loss-absorbing Capacity Term Sheet and clarifying the eligibility of instruments in the context of the internal TLAC ("the daisy chain proposal"). The political negotiations on this part of the Banking Package 2021 are progressing at speed. ECON published its draft report on the daisy chain proposal dated 15 December and the Council announced on 21 December that it had agreed its negotiating mandate on the proposals.

On 22 January 2021, Regulation (EU) 2021/23 on a framework for the recovery and resolution of central counterparties was published in the official journal of the EU. While the Regulation will apply generally from 12 August 2022, certain provisions concerning recovery plans will apply from 12 February 2022 (and provisions concerning the use of CCP's prefunded dedicated own resources and the compensation of non-defaulting clearing members, will apply from 12 February 2023).

The European Commission has also embarked on a review of the EU-bank crisis management and deposit insurance framework with a targeted consultation published in January 2021 and a public consultation published in February 2021. The Commission intends to undertake a targeted evaluation of the BRRD, SRM Regulation and the DGSD and address issues concerning the establishment of the European Deposit Insurance Scheme (EDIS). This evaluation will consider issues relating to MREL such as the difficulties faced by small and medium banks in accessing debt issuance markets and challenges relating to the sustainable build-up of MREL-eligible instruments. On 14 December 2021, the Commission published a document setting out possible items for College agendas in the period December 2021 – July 2022. This indicates that the EU-bank crisis management and deposit insurance package could be adopted following discussion at the Commission meeting on 13 July 2022.

UK

The largest UK banks must also now meet the UK's resolution outcomes (mid-tier firms have until 1 January 2023) and must publish a summary of their first resolvability assessment report, submitted to the PRA in October 2021, by 10 June 2022. The Bank of England will also make public statements concerning the resolvability of these firms at the same time as, or as soon as possible after, the firm's public disclosure.

In October 2021, the PRA published a consultation paper on its proposed expectations in respect of trading activities that may affect the financial stability of the UK. These expectations include that firms should be able to carry out a full or partial orderly wind-down of trading activities in recovery and post resolution restructuring. The consultation closes on 21 January 2022 and the PRA intends to publish its final policy in H1 2022. The proposed implementation date for the changes resulting from the consultation would be 1 January 2025.

Outsourcing and operational resilience

UK

The UK regulators have collectively designed a new framework to strengthen the resilience of financial institutions and financial market infrastructures (FMIs) to operational disruptions. FCA and PRA policy statements were published in March 2021 and firms have until 31 March 2022 to implement. Firms will then have a three-year transitional period to comply with rules requiring them to remain within their impact tolerance(s) for each important business service in the event of a severe but plausible disruption. The Bank of England also issued its supervisory expectations for the operational resilience of FMI in March 2021.

In November 2021, the PRA consulted on proposals to apply the group provisions in the Operational Resilience Part of the PRA Rulebook relevant to CRR firms to holding companies, and to make other minor formatting and clarification amendments to the Operational Resilience Part of the Rulebook (CP21/21). This consultation closes on 14 January 2022 and the PRA proposes that the implementation date for the changes resulting from this CP would be 31 March 2022 for the Operational Resilience Part and 1 January 2023 for the Operational Continuity Part.

EU

In September 2020 the European Commission adopted a legislative proposal for a Regulation on digital operational resilience for the financial sector, known as the Digital Operational Resilience Act or DORA. The initiative is designed to consolidate and upgrade information communication technology (ICT)-risk requirements to ensure that financial system participants are subject to a common set of rules to mitigate ICT risks for their operations. In November 2021, the Council announced that it has adopted its position on the proposals. On 13 December 2021, ECON announced its decision to open inter-institutional trilogue negotiations. It is expected that DORA will be published in the official journal in 2022.

AML/Financial crime

EU

On 20 July 2021, the European Commission announced a package of four legislative proposals to strengthen its anti money laundering and countering the financing of terrorism (AML/CFT) rules. The four proposals look at the establishment of a new EU AML/CFT authority, a new regulation looking at CDD and Beneficial Ownership, a legislative proposal repealing MLD4 (as amended by MLD5) and introducing MLD6 and a proposal to recast the Funds Transfer regulation in order to introduce new requirements relating to the transfer of cryptoassets. The focus of the proposals is on consistency, harmonisation, supervision and enforcement. It is expected that these proposals will be adopted during 2022 and will take effect during 2025.

UK

On 22 July 2021, HM Treasury published two documents relating to reform and review of the UK AML regime: (i) a consultation inviting views and evidence on the steps that the UK government proposes to take to amend the current MLRs in order to meet FATF standards and to provide clarity following feedback from industry and supervisors; and (ii) a call for evidence in relation to a review of the UK's AML/CFT regulatory and supervisory regime focusing on three themes – the overall effectiveness of the regime, whether key elements of the current MLRs are operating as intended and the structure of the supervisory regime, including the work of the Office for Professional Body Anti-Money Laundering Supervision. The consultation period for both documents closed on 14 October 2021.

This work will, in due course, inform the review of the MLRs which HM Treasury is required to report upon by 26 June 2022.

In addition to the above, from March 2022, the FCA's REP-CRIM reporting obligations will be extended to substantially more firms, including many payments firms, e-money firms, and all crypto exchanges and custodian wallet providers.

Financial markets

MiFID/MiFIR

EU

The MiFID II "quick fix" changes made in response to Covid-19 were due to be implemented by Member States at the end of November 2021 and apply from 28 February 2022. These centre predominantly on information and reporting requirements, product governance, research requirements and commodity derivatives requirements.

On 25 November 2021, the European Commission published its suggested changes to MiFIR and MiFID II as a result of the MiFID Review process (the Proposals). The Proposals form part of the Commission's Capital Markets Union reform package and, despite the breadth of the MiFID Review consultation process, focus on a limited range of changes – predominantly on market data (in particular the development of the consolidated tape) and transparency.

Key changes include: (i) adjustments to the scope of the STO and DTO; (ii) prohibition of payment-for-order-flow; (iii) removal of the "open access" obligation for ETDs; (iv) targeted changes to the equities and non-equities pre trade and post-trade transparency regimes (including the removal of the double volume cap and removal/simplification of pre-trade waivers and post-trade deferrals); and (v) standardisation of (and access to) market data through consolidated tape providers for different asset classes.

The MiFID II proposal is arguably far narrower than expected and for the most part simply complements the proposed amendments to MiFIR. In addition, there are two key proposals: (i) deletion of the RTS27 best execution reporting requirement; and (ii) deletion of the licensing requirement for persons dealing on their own account on a trading venue by means of DEA.

Both the MiFIR and MiFID II proposal will go through the ordinary EU legislative procedure during the course of 2022.

While the MiFID II changes outlined above are more limited in scope than some may have anticipated at the time the Commission launched the Consultation, it is worth noting that there may be future amendments via the EU retail financial services strategy, which is expected to be released in mid-2022. This could include amendments in relation to the investor categorisation framework.

UK

On 1 July 2021, HM Treasury published a consultation paper for its Wholesale Markets Review. The areas considered by HM Treasury in the consultation overlap in certain aspects with those being considered by the European Commission as part of the proposals following the review of the MiFIR/MiFID II framework, although, in other areas, HM Treasury has indicated a willingness to move ahead of the EU proposals. Areas under consideration include: (i) clarifying the regime applicable to trading venues (including the scope of the definition of trading venue); (ii) simplifying the regime applicable to systematic internalisers to reduce costs and increase liquidity; (iii) making targeted changes to the equities and non-equities pre-trade and post-trade transparency regimes; (iv) abolishing the STO and making adjustments to the scope of the DTO; (v) making fundamental changes to the regime applicable to commodities markets to remove excessive and ineffective requirements; and (vi) options to facilitate the creation of a consolidated tape. Legislation to implement the proposals is expected in 2022. The FCA is also expected to consult on related Handbook changes during Q1 and Q2 2022.

On 30 November 2021, the FCA published a policy statement intended to ensure that the rules for research and best execution are better tailored and more proportionate to the risks arising. The changes had originally been proposed in response to the changes made by the EU MiFID II "quick fix" amendments referenced above. From 1 December 2021, the best execution reporting obligation in RTS27 and RTS28 has been removed. From 1 March 2022, the inducement rules in COBS relating to research will be amended by widening the exemption of what constitutes a minor non-monetary benefit to include (among other changes) SME research and FICC research. Most of the other "quick fix" changes introduced during 2021 in relation to investor protection requirements and the position limits regime for commodity derivatives have applied since 26 July 2021.

For up to date briefings on the MiFID Review, please refer to our dedicated webpages which can be found here.

EMIR

EU

The phase-in of initial margin for uncleared derivatives will be completed with phase 6 counterparties coming into scope from 1 September 2022.

UK

In November 2021, the FCA and BoE launched their joint consultation on changes to reporting requirements, procedures for data quality and registration of Trade Repositories under UK EMIR. The proposals aim to align the UK derivatives reporting framework with international guidance from the CPMI-IOSCO to ensure a more globally consistent data set and streamline the process for the registration of Trade Repositories. The proposed amendments are expected to be published by mid-2022.

During the same month, the BoE also commenced its consultation on its approach to “tiering” non-UK CCPs based on the level of systemic risk they could pose to UK financial stability. The BoE currently expects that its final policy will start to apply from 1 July 2022.

The phase-in of initial margin for uncleared derivatives will be completed with phase 6 counterparties coming into scope from 1 September 2022 and the eligibility of EEA UCITS as the eligible collateral transitional period expires on 31 December 2022.

The BoE expects to consult on changes to the clearing obligation relating to the contract types referencing USD Libor during 2022.

Clearing and settlement – CSDR

EU

The CSDR settlement discipline regime is scheduled to start applying on 1 February 2022, however the co-legislators have agreed on an amendment to CSDR, to be introduced via the Proposal for a Regulation on a pilot regime for market infrastructures based on distributed ledger technology (MiDLT), which will allow ESMA to propose a later start date for the CSDR buy-in regime, while keeping the date of application of the penalties and reporting requirements unchanged. However, the adopted text of MiDLT is not expected to enter into force ahead of 1 February 2022.

To avoid potential additional costs linked to any additional later change of the systems and processes of market participants implementing these measures, ESMA published a letter on 17 December 2021 stating that it expects national competent authorities (NCAs) not to prioritise supervisory actions in relation to the application of the CSDR buy-in regime. Further with regards to the requirement in the Short Selling Regulation that CCPs include a buy-in regime in their operating rules, which is meant to be repealed upon application of the CSDR buy-in regime, ESMA expect NCAs to encourage CCPs to continue applying the buy-in rules currently implemented by them until the application of the revised CSDR buy-in regime. It is worth noting that the cash penalties regime is not expected to be delayed.

The CSDR requires the European Commission to review and prepare a report on the regulation and its implementation. In July 2021, the Commission published this report, which noted that in broad terms, the CSDR is achieving its original objectives to enhance the efficiency of settlement in the EU and the soundness of CSDs. In most areas, significant changes to the CSDR would be premature given the relatively recent application of the requirements. However it noted that concerns had been raised in relation to (among other things) the cross-border provision of services, access to commercial bank money, settlement discipline and the framework for third-country CSDs. In light of these concerns (and as announced in the 2021 Commission work programme and the second Capital Markets Union action plan), the Commission is considering presenting a legislative proposal to amend the CSDR, subject to an impact assessment that will examine the most appropriate solutions in more depth. A Commission document dated 14 December 2021 suggests that the CSDR Review will be discussed on 13 April 2022.

UK

In June 2020, the UK government confirmed that the CSDR settlement discipline regime would not be onshored and that any future legislative changes would be developed through dialogue with the financial services industry, and sufficient time would be provided to prepare for the implementation of any new future regime. Currently no proposals have been mooted.

PRIIPs

EU

In August 2021, the Commission published a Call for Advice to the Joint Committee of the ESAs inviting the committee to provide advice on certain prescribed areas. In October, the ESAs published a Call for Evidence to assist in the provision of the advice to the Commission as part of the PRIIPs review. The ESAs believe that additional changes to those identified by the Commission are required and as a result are seeking feedback across a range of issues including: (i) the use of the KID by financial advisers; (ii) the operation of the comprehension alert "You are about to purchase a product that is not simple and may be difficult to understand"; (iii) the practical application of the existing KID rules; (iv) the scope of the PRIIPs Regulation; (v) performance scenarios; and (vi) multi-option products.

The Call for Evidence closed on 16 December 2021 but the ESAs are not due to deliver their advice to the Commission until the end of April 2022. That advice will feed into the Commission's strategy for retail investments which is expected to be published in Q2 2022.

From July 2022, it is expected that the new PRIIPs RTS will apply to all products, including UCITS funds that were previously exempt. The new RTS will deliver several changes to the way costs, charges and performance scenarios are calculated and displayed, as well as introducing template amendments.

On 20 December, Regulation (EU) 2021/2259 amending the PRIIPs Regulation and Directive (EU) 2021/2261 amending the UCITS Directive were published in the OJ. The legislation extends the transitional arrangement exempting companies from the requirement to provide retail investors with a KID until 31 December 2022. The amendment to the UCITS Directive also specifies that a KID should be considered as satisfying the requirements applicable to key investor information. The legislation entered into force on 21 December 2021, the day after its publication in the OJ.

UK

The FCA published CP21/23 in July 2021 with the aim of addressing the areas of PRIIPs that "pose most harm to consumers". The Regulator wants to address the lack of clarity on the PRIIPs scope and address concerns with performance scenarios, summary risk indicators and elements of the transaction costs methodology.

The consultation closed at the end of September and according to the Regulatory Initiatives Grid published in November, the FCA has updated the timetable. Originally, it had expected final rules to take effect in January 2022 but it is now aiming to publish the policy statement in Q1 2022 and will include confirmation of when the rules will take effect and any implementation period.

In addition to the above, HM Treasury confirmed in June 2021 that the UK will extend the UCITS exemption by five years until 31 December 2026. During that time, HM Treasury is expected to conclude its review of the UK retail disclosure regime and this may lead to changes to the UK PRIIPs regime before 2026. If that happens, HM Treasury has confirmed that it would "ensure a smooth transition to the new regime for all retail investment product providers, including those marketing UCITS funds".

Short selling

In September 2021, ESMA published a consultation paper as part of its review of the Short Selling Regulation. The consultation focuses on three main aspects: (i) the impact of short-selling bans adopted during the Covid-19 pandemic; (ii) a review of the current framework for the calculation of net short positions (NSPs), the "locate rule" and amendments to the list of exempted shares; and (iii) a review of the framework for transparency and publication of NSPs.

The consultation closed on 19 November 2021. It is expected that ESMA will publish a final report by the end of Q1 2022 to enable the Commission to consider whether legislative change is appropriate.

FinTech/Digital Assets

EU

Digital Finance Package

In the context of the Digital Finance Strategy, the European Commission published a call for technical advice to the ESAs in February 2021. The final joint report is expected by 31 January 2022 and will consider value chains, "platformisation" and mixed activity groups. In March 2022, the EBA is expected to publish a final report on non bank lending. The Commission is also expected to continue to progress its Retail Finance Strategy.

MiCA, DORA and the adoption of DLT pilot

As part of progressing the Digital Finance Strategy, it is expected that trilogue negotiations between the Commission, the European Parliament and the Council will begin shortly on the legislative text of the Markets in Cryptoassets Regulation (MiCA) and Digital Operational Resilience Act (DORA).

In relation to the legislative framework for a pilot regime to test market infrastructures based on distributed ledger technologies (DLT), the Council of the EU and the European Parliament reached political agreement on 24 November 2021. The Regulation is expected to be formally adopted during 2022 and will come into force 20 days after its publication in the Official Journal and will apply nine months after it has entered into force.

UK

Regulation of stablecoins and cryptoassets

In January 2021, HM Treasury published a consultation paper looking at regulating certain stablecoins and a call for evidence on the use of cryptoassets for investment purposes and the use of distributed ledger technology (DLT) in financial services. The consultation proposed expanding the regulatory perimeter to cover stable tokens used as a means for payment. Reflecting FSB recommendations, HM Treasury anticipates that regulation would apply in relation to a wide number of activities including issuance, destruction, value stabilisation and reserve management, validation of transactions, facilitating access, settlement, custody and administration, executing transactions and fiat-token exchange. The consultation closed on 21 March 2021 and a response plus further consultations on specific rules are expected during 2022.

Property status of digital assets

In April 2021, the Law Commission published a call for evidence on digital assets which sought views and evidence on the ways in which digital assets are being used, treated and dealt with by market participants. It also sought views on the potential consequences of digital assets being "possessable". The call for evidence closed on 30 July 2021. The Law Commission plans to publish a consultation in mid-2022 on whether it would be appropriate for English law to recognise that certain digital assets could fall within a "third category" of personal property which is neither a thing in action nor a thing in possession, and how that category of property should be treated.

Asset management and investment firm regulation

Prudential regulation of investment firms

The UK's new prudential regime for investment firms commenced on 1 January with the application of a new sourcebook of the FCA's Handbook (MiFIDPRU) and introduction of the MIFIDPRU Remuneration Code in new SYSC 19G. Throughout 2022, FCA-authorised investment firms will be grappling with the new ICARA process and documentation and reporting requirements. For more information on the new regime and its EU equivalent please see our dedicated webpage which can be accessed here.

AIFMD review

EU

On 25 November 2021, the European Commission published its long awaited legislative proposal following the AIFMD Review (the Proposals). The Proposals, which also include amendments to the UCITS Directive, cover delegation and substance, liquidity-risk management, loan origination, depositary functions, data reporting and supervisory convergence.

Key elements of the Proposals include:

- Delegation: the proposed amendments include applying delegation rules to core and ancillary regulated activities, imposing minimum substance requirements to harmonise requirements across the EU and bi annual peer reviews by ESMA of delegation arrangements to third-country entities.
- Lending activities: the Proposals add "originating loans" to the list of activities that an AIFM may perform, with the Commission's explanatory text adding that "this means AIFs could extend loans anywhere in the Union, including cross-border". Skin-in-the-game, concentration measures and conflicts measures are also introduced.
- Liquidity-risk management: additional liquidity-risk management provisions have been proposed, including a list of liquidity-risk management tools which national competent authorities must make available to AIFMs and from which AIFMs that manage open-ended AIFs must select at least one.
- Disclosure and reporting: additions are made to the matters that must be disclosed to investors, such as lists of fees and charges, and ESMA is tasked with drafting a revised Annex IV reporting template.
- Depositaries: while a depositary passport is not being introduced, the Proposals seek to improve access arrangements for depositary services across borders while also widening the scope of the entities that are considered delegates of depositaries to include central securities depositaries.
- UCITS: the aim of the amendments to the UCITS Directive is to harmonise the framework with the AIFMD in the areas of delegation, liquidity management and supervisory reporting.

The Proposals will now be debated by the Council and the European Parliament and it is expected that an agreement will be reached by mid to late 2022. Publication in the official journal of the EU would likely follow in early 2023, with Member States having 24 months to implement the changes. This means the Proposals, if adopted, are likely to start applying from the end of 2024 or early 2025.

UK

The UK government is not currently considering changes to these regimes. In the Call for Input mentioned below, the government explicitly excluded from the scope of the review any analysis of the UK's versions of AIFMD and the UCITS Directive, noting it does not intend to make changes to those "at this time".

Future UK Funds regime

As referenced in the cross-sector section, the UK Government is currently reviewing several areas of the financial services framework in the light of Brexit. One key area of focus is the UK funds regime, and in January 2021, HM Treasury published a Call for Input on the review.

The aim of the Call for Input is to find ways of making the UK a more attractive location in which to set up, manage and administer funds, (and one which supports a wider range of funds). This also requires considering what tax reforms would be needed to support such a framework while remaining compatible with the UK's international commitments. The government is interested in the use of authorised fund structures for certain types of professional investors (including DC pension schemes), and issues such as speed to market and how the authorisation process can be improved.

The Call for Input closed in April 2021 and it is expected that during 2022, the government will consult on specific proposals for reform most likely prioritising those initiatives that will deliver the greatest impact in the shortest time.

In addition to the above, in October 2021 the FCA published its final rules for a new category of open-ended authorised fund designed for investing in long-term illiquid assets. The Long Term Asset Fund (LTAF) structure allows wider access to assets such as infrastructure and private companies which are not regularly traded. It is intended to provide the benefits of greater diversification for pension savers and investors, while helping to provide much needed additional investment for the UK economy. The FCA intends to consult on the potential for widening the distribution of the LTAF to a broader range of retail investors during the first half of 2022.

Overseas Funds Regime

The Financial Services Act 2021 introduces a new regime, the Overseas Funds Regime (OFR), which provides for new equivalence regimes for retail investment funds and money market funds. The OFR provisions in the Financial Services Act 2021 are not yet in force. They will enter into force on such date as HM Treasury may specify in regulations.

The FCA is now working on operationalising the OFR and will be consulting on various aspects of the handbook rules throughout 2022 to ensure OFR funds are appropriately captured.

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