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Financial Services Horizon Report

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Index

Click to navigate through the document.

Overview of the year ahead 03

Timeline 06

Cross-sector 07
Future UK Regulatory Framework 07
UK Perimeter/regulated activities 07
Financial promotions and marketing 08
Individual accountability 08

Sustainability 09
Climate change and ESG 11
Disclosure and reporting 11
SDR and labelling regime 11
Greenwashing risks and issues 12
ESG ratings 12
Net zero targets 12
Transition plans 12

Banks and bank regulation 14
Prudential 14
Recovery and resolution 16
Outsourcing and operational resilience 18

AML/financial crime 19
AMLD 19
Economic Crime and Corporate Transparency Bill 2022 20
UK carrying out targeted review of AML and CTF regime 20
Regulation 5 of the Money Laundering and Terrorist Financing (Amendment) (No 2) Regulations 2022 (SI 2022/860) 21
The first payments for the Economic Crime (Anti-Money Laundering) Levy Regulations 2022 are due 21

Financial markets 22
MiFID/MiFIR 22
MAR 24
UK CCP/CSD regulation 26

Payment services and payment systems 28
Payment Services Regulations review and call for evidence 28
PSR market reviews into card fees 28
PSR Confirmation of Payee 28
PSR mandatory reimbursement for APP fraud 29
HMT consultation and call for evidence on payments regulation and the systemic perimeter 29
European Commission review of PSD2 29

FinTech/Digital Assets 30
Digital Euro 30
MiCA and the adoption of DLT pilot 30
Property status of digital assets 31
FMI sandbox 31
Future UK financial services regulatory regime for cryptoassets 31
Digital pound 31

Asset management regulation 32
Cross border marketing 32
ELTIFs 32
MMF policy framework 32
AIFMD and UCITS Directive review 33
PRIIPs 33
New Consumer Duty 34
Long Term Asset Funds 35
Overseas Funds Regime 35

Overview of the year ahead

2023 looks set to be yet another year dominated by regulatory reform for financial services firms. This document considers a number of key developments including the UK's Financial Services and Markets Bill (**FSM Bill**) and Edinburgh Reforms, the EU's 2021 Banking Package and updates in relation to the regulation of digital assets.

Please note that the document does not seek to cover all regulatory developments planned for 2023. In particular, it does not consider changes planned for the retail, insurance or pensions sectors, although the FCA's new Consumer Duty will have ramifications that permeate the markets. Please see "Consumer Duty – what does it mean for wholesale firms?" or listen to our podcast on "A new Consumer Duty – what should payments and e-money firms do?" for more information. We also discuss it further in the funds and asset management section.

The timing of a number of updates remains uncertain and in some instances we are unable to identify when in 2023 they are anticipated. In December 2022, it was announced that publication of the sixth edition of the UK's Regulatory Initiatives Grid was delayed from November 2022 to "the New Year". We understand that it is now anticipated in Q1. Once published, we would expect further clarity on the timing of a number of UK initiatives.

The Brexit legacy – divergence and 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 includes a number of areas in which the UK's policy objectives diverge from those of the EU.

Reform of the framework is progressing at a number of different levels. Following the UK government's consultation in 2020 on the Future Regulatory Framework, the FSM Bill was introduced into Parliament in July 2022. The Bill is expected to receive Royal Assent in the Spring of 2023 and will be followed by an immense programme of regulatory reform designed to revoke retained EU law relating to financial services and replace it with regulator's rules.

Whilst the scheduling of that reform remains to be fully determined, the Bill contains transitional amendments to a number of the retained EU markets legislative instruments following the UK's Wholesale Markets Review. These include in relation to the Markets in Financial Instruments Directive and Regulation, the European Market Infrastructure Regulation and the Securitisation Regulation (most of which are also under review in Europe).

On 9 December, the UK government released a package of reforms referred to collectively as the 'Edinburgh Reforms'. These include a policy statement on 'Building a smarter financial services framework for the UK'. This sets out the government's plan for the regulatory reform process. The government intends to manage the reform in 'tranches', prioritising areas of legislation where there is the greatest opportunity for beneficial policy reform. It has identified 43 'core' files of retained EU financial services law that it intends to repeal in a series of 'tranches'.

The first tranche seeks to deliver the outcomes arising from the Wholesale Markets Review, Lord Hill's Listing Review, the Securitisation Review, and the Review into the Solvency II Directive. The second tranche includes the Packaged Retail and Insurance-Based Investment Products (PRIIPS) Regulation, the Short Selling Regulation, the Taxonomy Regulation, the Money Market Funds Regulation, the Payment Services Directive, the E-Money Directive consumer information rules in the Payment Accounts Regulations 2015, the Capital Requirements Regulation and Directive and the Long-Term Investment Funds Regulation. The government expects to 'make significant progress' on tranches 1 and 2 by the end of 2023. How far and how fast the UK's reform agenda will go, however, still remains to be seen.

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 continue to grapple with how they approach and manage divergence during the course of 2023 and how they engage with the process of adapting and moving the UK's legislation into the regulators' rulebooks.

Furthermore, in the UK, the Retained EU Law (Revocation and Reform) Bill 2022 was introduced to Parliament in the Autumn of 2022 (colloquially referred to as the Brexit Freedoms Bill). Whilst its "sunset" provision does not apply to financial services law within the scope of Schedule 1 of the FSM Bill, as drafted it will still impact financial services legislation. In particular, it proposes to repeal the principle of supremacy of EU law by the end of 2023, facilitate domestic courts departing from retained case law, repeal directly effective EU law rights and obligations in UK law by the end of 2023 and abolish general principles of EU law in UK law by the end of 2023.

Attitudes to cross border provision of financial services

EU

On 8 December, ESMA published a peer review report into the national competent authorities' handling of relocation to the EU in the context of the UK's withdrawal from the EU. The report contains a number recommendations aimed at "strengthening the authorisation process of the NCAs". This report and the NCAs' responses will likely shape ESMA's future policy work in this area.

ESMA's report follows the European Central Bank's (ECB's) 'desk-mapping' review exercise which sought to assess the governance and risk management capability of EU banking entities of overseas banks. This exercise resulted in the ECB issuing both general and firm level expectations on risk management and booking model practices of EU banking entities that are headquartered overseas.

EU policy relating to the authorisation and supervision of third country headquartered firms will also need to be considered in light of the 2021 Banking Package. The European Commission proposed a far-reaching prohibition on cross border services which has been watered down in the Council's compromise text, but firms should keep a watching brief over the political negotiations. See our bulletin on EU proposals to regulate third country providers of financial services for more information.

UK

HMT's review into the UK's overseas framework remains outstanding. Following the delay announced in December 2021, HMT has not committed publicly to a timeline for publishing its consultation on this issue.

Negotiations on the ambition of delivering a comprehensive mutual recognition agreement (MRA) that would reduce costs and barriers for UK firms accessing the Swiss market, and vice versa also hasn't progressed, at least publically, as much as might much as might have been anticipated. In January 2021, the government stated that negotiations were expected to cover a wide range of sectors such as insurance, banking, asset management and capital markets, including market infrastructure. In December 2022, the finance ministry was reported to say that it expects to conclude the MRA by late summer 2023.

31 December 2022 marked the deadline for solo-regulated EEA firms in the temporary permission regime (TPR) post Brexit to apply for FCA authorisation. In 2023, the TPR should only include firms with long-term UK plans that have applied for full authorisation or registration. Firms that have not applied are expected to voluntarily leave or otherwise expect enforcement action to remove them. All firms in the TPR are expected to have had their authorisation or registration applications determined by the end of 2023, when the TPR is scheduled to end. The temporary recognition regime for overseas CCPs has been extended until 31 December 2024.

Competition in the sector

The Competition and Markets Authority (CMA) launched an investigation into suspected anti-competitive arrangements in the financial services sector in November 2018.
The investigation is ongoing and the CMA state that no assumption should be made at this point that competition law has been infringed. It expects to provide an update on its ongoing investigation in Spring 2023.

Data

The UK regulators continue to engage with firms on their data collection transformation programme, in particular with its digital regulatory reporting initiative. The phase one implementation stage runs until Q2 2023 alongside the phase two discovery and design stage.

Timeline

Click on a theme (▶) to read more.

Cross-sector

Future UK Regulatory Framework

A 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 government considers the FRF Review to represent 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 have been undertaken in specific areas of financial services regulation. These include the government's reviews into the prudential regime for insurers, wholesale capital markets, the UK listing regime and the UK funds regime.

The government's proposals in relation to the framework for the UK's future regulatory framework are contained in the FSM Bill, introduced into parliament in July 2022 and making its way through the legislative process. Expectations at the time of writing are that the Bill will receive Royal Assent in the Spring of 2023. It will then be followed by an ambitious programme of regulatory reform. As discussed above, the extent and speed of this reform remains to be seen, but industry will have to monitor and manage this change agenda attentively.

UK Perimeter/regulated activities

The revised Appointed Representatives regime

The FCA's new rules for appointed representatives came into force on 8 December 2022, following which principal firms received a Section 165 request requiring information about their appointed representatives. Firms have until 28 February 2023 to respond. The information will inform the FCA's work across sectors and portfolios, and assist in the identification of drivers of harm.

Going forward, firms will have to notify the FCA at least 30 days in advance of any appointed representative appointment. To the extent that an individual needs FCA approval before it can carry out its regulated activities, firms should be mindful that individual approvals applications can take up to 3 months, so in many cases it will take longer than 30 days for an appointed representative appointment to complete.

Firms are also now subject to enhanced reporting requirements and an annual review requirement, the documentation and process around which will occupy principal firms in 2023.

The Designated Activities Regime

The FSM Bill creates a new, parallel licensing regime under the Financial Services and Markets Act 2000 (FSMA), the Designated Activities Regime (DAR). The FSM Bill will amend FSMA to grant HM Treasury the power to make regulations providing for an activity to be a 'designated activity', if it relates to "financial markets or exchanges of the United Kingdom", or "financial instruments, financial products, or financial investments that are (or are proposed to be) issued or sold to, or by, persons in the United Kingdom". The FCA is then granted a rule-making power, which will enable it to make rules in relation to designated activities within the accountability and objectives framework for financial services regulators set by Parliament.

Whilst persons carrying out designated activities will not need to be FCA-authorised or meet any threshold conditions (unless carrying out standard regulated activities under FSMA); they will be required to follow the regulators' rules in relation to the specific designated activity itself.

The DAR is intended to maintain the purview of the FCA over certain activities, products and conduct that are currently regulated by retained EU law but that are not regulated activities under the FSMA. Whilst it may at first be used to replace the retained EU law that is being revoked under the FSM Bill, there is no apparent limitation to the Treasury extending it in the future to new activities or products which bring new risks (eg in relation to cryptoassets).

Review of ring-fencing and proprietary trading

As part of the Edinburgh Reforms, the Government announced that it will consult on reforms to the ring-fencing regime in mid-2023, with a view to bringing forward secondary legislation. The reforms that the Government proposes to take forward will reflect many of the recommendations of the Independent Review led by Keith Skeoch and published in March 2022. In addition, the Government proposes to increase the threshold at which ring-fencing applies from GBP25 billion in retail deposits to GBP35bn.

The Government intends to launch a public call for evidence in Q1 2023, asking for views on the long-term benefits of the ring-fencing regime in light of developments in the resolution regime and relevant advances in the wider regulatory framework. This is intended to inform decisions on the long-term future of the ring-fencing regime, to be taken later in this Parliament.

Financial promotions and marketing

In August 2022, the FCA published its final rules on strengthening its financial promotion rules for high-risk investments and firms approving financial promotions. Rules related to risk warnings for financial promotions of high-risk investments took effect from 1 December 2022. All other rules, including a package of measures to strengthen the role of a section 21 approver will have effect from 1 February 2023. Additionally, the second phase of the FCA's review of financial promotion rules for high-risk investments is expected in 2023.

In December 2022, the FCA launched a consultation on 'Introducing a gateway for firms who approve financial promotions'. The consultation closed on 7 February 2023, and the FCA expects to publish its Policy Statement and final rules in the first half of 2023. This follows an HMT consultation in July 2020 and subsequent consultation response, which confirmed the Treasury's intention to introduce a new regulatory gateway for all authorised firms under FSMA who wish to be able to approve financial promotions on behalf of unauthorised persons. The FSM Bill includes provisions to amend FSMA to create this regulatory gateway for s21 approvers.

The government is aware that this will be a significant change for firms that approve financial promotions, and that some firms may no longer wish to continue this activity as a result. The government proposes to implement a transitional period to allow time for firms to adjust to the gateway requirements and for the FCA to determine applications for firms that do wish to carry on under the new regime.

The government is also looking to bring certain qualifying cryptoassets into the financial promotions regime. The detailed FCA rules for this regime will be set independently by the FCA once the relevant legislation to bring qualifying cryptoassets within the financial promotions regime has been made. In addition, on 1 February 2023, the government published a Policy Statement on its approach to cryptoasset financial promotions regulation. The Policy Statement sets out the government's intention to introduce a bespoke exemption to s21 FSMA for cryptoasset businesses registered with the FCA under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs). This exemption is temporary, and will enable cryptoasset businesses which are registered with the FCA under the MLRs, but who are not otherwise authorised persons, to communicate their own cryptoasset financial promotions to UK consumers. The government will seek to introduce the statutory instrument giving effect to the planned cryptoasset financial promotions regime, including the temporary exemption to S21, as Parliamentary time allows. The Policy Statement also sets out the government's intention to reduce the implementation period for the regime from 6 months to 4 months from the relevant legislation being made in Parliament. The Treasury will review its approach to the exemption, alongside the future regulatory approach to cryptoassets, in due course.

Individual accountability

On 9th December, as part of its package of Edinburgh Reforms, HMT announced its intention to commission a review of the senior manager and certification regime (SMCR). Information about what this review will look like is scarce but the government will launch a call for evidence to look at the legislative framework that underpins the SMCR in Q1 2023. This legislation deals with the higher level points, such as which firms fall within the scope of the SMCR, the regulators' power to specify Senior Management Functions, firms' obligations to issue certificates of fitness and propriety on an annual basis and the requirement for firms to provide tailored training to their staff who are subject to the regulators' Codes of Conduct.

The FCA and the PRA will also review their regulatory frameworks for the SMCR. This review is more likely to grapple with the more granular aspects of the SMCR, which are detailed in the FCA Handbook and the PRA Rulebook.

The FSM Bill prescribes a framework for a SMCR framework for CCPs and CSDs that is similar to the existing SMCR for banks, insurers and other authorised persons. Recognised Investment Exchanges are also within scope of the framework and the FSM Bill gives HMT the power to apply the regime to credit rating agencies. The government will be able to decide when to apply the regime to any of the entity types and to tailor the regime to each type.

When HMT applies the regime to CCPs and or CSDs, the Bank will be given new powers to implement, supervise and enforce the SMCR and conduct rules.

The FCA and HM Treasury had also previously indicated that they were considering extending the SMCR to payment and e-money firms. These plans may well now be on ice, pending the outcome of the government and regulators' reviews.

Sustainability

Disclosure and reporting

Within the EU, companies are likely to be subject to enhanced ESG related disclosure and reporting requirements going forward. This includes requirements under the draft Corporate Sustainability Reporting Directive or CSRD. Among other things, this will extend the application of the current regime (the Non-Financial Reporting Directive or NFRD) to more companies, will introduce more detailed reporting requirements, and will require adherence to mandatory EU sustainability reporting standards. It is also likely to require information to be reported to be subject to a limited level of assurance or audit, and for in scope companies to digitally tag information so it is machine readable and can feed into an EU single access port. If and when finalised, the new regime will start to apply in stages, beginning in 2024.

Alongside this, the Commission has been working on a draft Corporate Sustainability Due Diligence Directive (known as CSDD or CS3D). This would introduce a due diligence duty on large EU companies and non-EU companies with significant EU activity, in respect of actual or potential adverse human rights and environmental impacts in their operations, their subsidiaries and their value chains. The Council has adopted a negotiating position and this now needs to be negotiated with Parliament, which is expected to adopt a position in H1 2023. Aspects of this initiative have been controversial in the financial services sector, and lobbying is ongoing.

SFDR and labelling

The EU Sustainable Finance Disclosure Regulation (SFDR) was introduced to increase transparency in relation to sustainability among asset and fund managers (among others) and mitigate greenwashing risks. It is also part of a broader series of regulatory initiatives intending to "mainstream" the consideration of climate change risk (and ESG risks generally), and foster long-termism. SFDR consists of various disclosure requirements at an entity and product level, and has been coming into force in stages.

From 1 January 2023, relevant firms began to be required to issue detailed disclosures for products in scope in line with templates included in the SFDR RTS. The form of these templates is being updated in early 2023, following a lengthy debate on fossil gas and nuclear energy.

Full entity level PAI reports are due in June 2023, based on the reference period of 1 January 2022 to 31 December 2022. In October 2022, the ESAs sent a letter to the European Commission regarding the status of the development of amendments to Delegated Regulation (EU) 2022/1288, which supplements the SFDR with RTS on content and presentation of information. The Commission had mandated the ESAs to make amendments to RTS laid down in the SFDR regarding principle adverse impacts (PAI) indicators and transparency by financial products, by April 2023. However, the ESAs do not consider it possible to meet this deadline but rather anticipate a six-month delay. The expectation is that the ESAs will publish the proposed amendments in November 2023.

A number of other initiatives in relation to SFDR are currently underway or expected. By way of example, the Commission is working on a Q&A in response to issues raised by the ESAs and is also believed to be assessing the implementation of SFDR, with the intention of publishing a consultation in early 2023.

Additionally, ESMA published a consultation paper in November 2022, on guidelines on funds' names using ESG or sustainability-related terms. In the paper, ESMA recognizes the importance of fund names as a marketing tool, and expresses concerns about investors being misled if ESG related terms are used in a fund name but not reflected fairly and consistently in the fund's investment objectives and policy. ESMA therefore seeks input on the introduction of standards and thresholds for firms wishing to use certain ESG or sustainability-related terms in the name of a fund.

The paper includes a proposal for a quantitative threshold of 80% where a fund wishes to use ESG related words in its name, an additional threshold of 50% (of that 80%) if the name includes the word “sustainable” or any sustainability-related term, the application of minimum safeguards to all investments for funds using such terms, and additional considerations for specific types of funds (eg index and impact funds). The industry currently expects final guidelines in Q2 or Q3 2023. They will apply across the board, not just retail facing business.

Greenwashing risks and issues

Greenwashing has been a focus for many European regulators and as demand for and offer of sustainable investments continues to grow, it is only reasonable to expect more regulation and attention directed at the industry and its claims.

In November 2022, the ESAs expressed their commitment to preventing greenwashing, by launching a call for evidence looking to understand the key features, drivers and risks associated with greenwashing. The ESAs expect to publish their progress report in May 2023, with the final report due in May 2024.

In 2022, ESMA issued its Sustainable Finance Roadmap, setting out a series of initiatives and priority areas for action that will continue to be rolled out in 2023 and 2024, including on greenwashing.

ESG and ratings

The Commission has been considering its position on the regulation of ESG ratings providers, as well as sustainability risks in credit ratings. There is a suggestion it may present a proposal on these topics in H1 2023.

Other initiatives

In December 2022, the EBA also published a roadmap, with work planned in a number of areas including templates on ESG risks, sustainability reporting standards, planned guidelines on ESG risks, the prudential treatment of ESG related exposures, stress testing, and standards/labels. The EBA is also due to report to the Commission on green loans and mortgages.

In early 2023, ESMA is also likely to publish its updated product governance guidelines in final form, including comments on ESG related matters.

More broadly, sustainable finance continues to be a major priority for the Commission, with the invasion of Ukraine being viewed as a reason to accelerate the green transition. Work on the establishment of an EU Green Bond Standard (EU GBS) is also ongoing, but may come to fruition in 2023.

Prudential

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.

Strengthening the resilience of the banking sector to environmental, social and governance (ESG) risks is a key area of the Commission’s Sustainable Finance Strategy. The European Commission’s Banking Package 2021 contains proposals aimed at improving the way banks measure and manage these risks, and to ensure that markets can monitor what banks are doing. The proposal will require banks to systematically identify, disclose and manage ESG risks as part of their risk management. This includes regular climate stress testing by both supervisors and banks. Supervisors will need to assess ESG risks as part of regular supervisory reviews. All banks will also have to disclose the degree to which they are exposed to ESG risks. To avoid undue administrative burdens for smaller banks, disclosure rules will be proportionate. The Banking Package is still going through the political and legislative process and remains subject to finalisation and publication.

From 26 December 2022, Class 2 EU investment firms are also expected to disclose information on ESG risks, including physical risks and transition risks, as further defined in the EBA’s 2021 report on the management and supervision of ESG risks for credit institutions and investment firms, and as complemented by the EBA’s October 2022 report on incorporating ESG risks in the supervision of investment firms.

Climate change and ESG

A number of new laws and regulatory initiatives have been introduced in the UK, and/or are likely to be introduced in the coming months and years, in relation to climate change and ESG. This reflects the strong focus on these subjects by regulators, governments, central banks and the public, in particular the act of greenwashing. There is also an increased focus in the market, and by investors, customers (both retail and institutional) and other stakeholders.

Some of the key laws and regulatory initiatives introduced or being considered in the UK relevantly include the following.

Disclosure and reporting

In January 2022, the new FCA climate related disclosure rules, applied to the largest firms. From 1 January 2023, it applied to the smaller firms falling within the scope of the rules. The new rules, contained in the FCA's ESG Sourcebook, require firms to disclose information on how they are managing climate related opportunities and risks, including in respect of governance, risk management and climate related metrics and targets. Firms are also required to make disclosures about the climate-related attributes of their products.

These rules build on the TCFD based disclosure regime that the FCA has begun to roll out for certain UK listed issuers under the UK listing rules. In due course, it is likely that the UK government and regulators will require disclosures to be prepared in line with the new sustainability disclosure standards being worked on by the International Sustainability Standards Board.

The disclosures may also have to reflect the UK taxonomy currently under development, which intends to document a shared understanding as to what can be considered an environmentally sustainable economic activity. Work is currently under way on this (leveraging the EU's work on its own taxonomy regime). The UK Government is expected to consult on aspects of the UK green taxonomy in due course, although with delays having been announced, the precise timing is unclear.

SDR and labelling regime

2023 will see the FCA publish a final policy statement on the UK Sustainability Disclosure Requirements (SDR). The FCA began its work in October 2022 when it published a consultation paper setting out the details of a new ESG labelling regime, as well as the first phase in the roll out of SDR for the UK financial services industry. The bulk of the provisions in the consultation concern UK asset and fund managers, with additional provisions applicable to advisers, platforms and other types of distributors.

The labelling regime will require firms to consider if they wish to use the label or not, with any new or existing funds and portfolio managed clients. If a label is used, prescribed criteria and implementation guidance must be met. This is highly onerous. If a label is not used in relation to retail facing business, changes may need to be made to a relevant fund and/or its name and marketing materials to comply with the ban on retail facing business using prescribed terms such as "ESG", "impact", "green", "sustainable" or similar where a label is not used (subject to exceptions).

Initially, the regime will not apply to overseas funds, but the FCA has foreshadowed a future consultation on extending the regime to cover overseas retail funds sold into the UK. If this requirement materializes, it may pose significant challenges for international groups in having to potentially comply, simultaneously, with the current EU disclosure regime (as well as any labelling requirements they might prescribe in the future), as well as those in force in the UK.

The FCA intends to set out rules in a final policy statement by June 2023. The requirements are expected to come into effect in phases, for example the labelling, naming, marketing and initial disclosure requirements by 30 June 2024.

Greenwashing risks and issues

The FCA's October 2022 consultation paper setting out the details of a new ESG labelling regime also proposed a new anti-greenwashing rule that will apply to all regulated firms. Firms will need to ensure that any reference to the sustainability characteristics of a product or service is consistent with the sustainability profile of that product or service, and is clear, fair and not misleading. This "anti-greenwashing rule", is intended to enter into effect as soon the FCA publishes the relevant policy statement.

The FCA also issued a Dear Chair letter in July 2021, expressing concerns about standards in the authorised funds industry as regards funds whose strategies focus on ESG themes, and providing a set of guiding principles to clarify expectations. The FCA is expected to continue its work on this area in the coming 12-24 months, at minimum, via its fund authorisation process and via supervisory engagement.

Other UK initiatives include the Green Claims Code published by the Competition and Markets Authority, which sets out principles for businesses making ESG claims. The UK Advertising Standards Authority (ASA) can also consider potential greenwashing issues in advertisements.

At a global level, the International Organization of Securities Commissions (IOSCO) published a call for action on 7 November 2022, calling on voluntary standard setting bodies and industry associations to promote good practices among members to counter the risk of greenwashing related to asset managers and ESG rating and data providers.

ESG ratings

In December 2022, the UK government announced that it would consult in 2023 on a proposal to require ESG ratings providers to be subject to authorization in the UK going forward. It has stated that these services are increasingly a component of investment decisions, and the government wants to ensure improved transparency and good market standards. Industry work is also underway on a code of conduct.

This initiative may have significant knock on impacts for financial services firms generally, given the increased commercial pressure from investors and the market for ESG data and for issuers and/or financial instruments to be the subject of ESG ratings or scores.

Among other things, this enables investors and the market to assess how ESG friendly a financial instrument, issuer or firm may be. It may also assist investors in incorporating ESG risk into their investment decision making process, which is an increasingly trend and the preferred approach from a regulatory perspective.

Net zero targets

The UK Government has expressed an ambition for the UK to be "the first ever Net Zero Aligned Financial Centre" and "the best place in the world for green finance". In May 2022, the government issued a call for evidence and is expected to publish an updated Green Finance Strategy in early 2023. This is likely to include a number of new policy initiatives. With the UK currently not on track to meet its fourth or fifth carbon budgets, and the Committee on Climate Change expressing its commitment to the UK's net zero target for 2050, it is possible that more ambitious initiatives will be published over the next 12-24 months, with the aim of getting back on track.

Transition plans

In May 2022, the UK Transition Plan Taskforce (TPT) issued a call for evidence, seeking views on the principles and elements of a Sector-Neutral Framework for private sector transition plans. The TPT has published draft recommendations so far, suggesting 19 sub-elements within five elements (foundations, implementation strategy, engagement strategy, metrics and targets, and governance). Disclosure recommendations are included for each sub-element. There is also draft implementation guidance, and a recommendation on disclosure: a standalone transition plan should be published at least each three years, or sooner if there are significant changes. Progress should be reported annually in general financial reporting.

The TPT is now developing the Sector-Neutral Framework, with a view to the final framework being published in early 2023. Given the importance of transition plans, it is likely that the output of the TPT will be reflected in FCA requirements in due course.

Other initiatives

The FCA is continuing its work on stewardship, as the new UK Stewardship Code beds down. The deadline for applications for the next round of applicants is in April 2023.

The FCA's ESG Strategy published in 2021 is likely to be updated over time. Its 2022/2023 Business Plan and 2022-2025 FCA Strategy also underlined a focus on "integrity in the market for ESG labelled securities, supported by the growth of effective service providers" and the FCA's view that "the financial sector has an important role to play in supporting the transition to a net zero economy and a more sustainable long term future."

The PRA and FCA are conducting ongoing work on diversity in financial services, following the introduction of new listing rules. A consultation on diversity and inclusion in the financial services industry is expected in 2023, although the FCA published some interim views in December 2022.

In the 2021, HMT roadmap, it was stated that HMT and the FCA were exploring how best to introduce sustainability-related requirements for financial advisors. The intention is to ensure they take sustainability matters into account in their investment advice and understand investors' sustainability preferences to ensure suitability of advice. This work is believed to be ongoing, but the timing is unclear.

Banks and bank regulation

Prudential

International standards

The BCBS expect member states to implement the outstanding Basel III (Basel 3.1) reforms by 1 January 2023. Each of the EU, UK and US have indicated that they anticipate implementation from 1 January 2025 and we anticipate finalisation of their respective policy and implementation proposals in 2023.

The UK's proposals are currently subject to consultation, which will close on 31 March 2023. They generally adhere to the Basel standards, subject to "targeted measures" to address concerns with respect to risk-weighting of exposures to unrated corporates under the credit risk standardised approach (SA) and the calibration of the standardised approach to counterparty credit risk (SA-CCR). In June 2022, the PRA published a letter to firms detailing its timetable for submission of certain pre-applications with respect to the revised market risk and credit valuation adjustment (CVA) framework. The PRA expects firms to submit final pre-application materials at least 12 months before the proposed implementation date of Wednesday 1 January 2025 (ie by 1 January 2024). Firms affected by the Basel 3.1 amendments will be monitoring the development of the PRA's proposals and considering their impacts and any pre-application requirements by year end.

EU Banking Package 2021/CRDVI

The EU's proposed implementation of Basel 3.1 policy is contained in the European Commission's Banking Package 2021, which proposes numerous further amendments to the Capital Requirements Regulation (CRR) and fourth Capital Requirements Directive (CRDIV). These proposals remain subject to political negotiation. The Council adopted its general approach in November 2022 and the European Parliament agreed its position on 24 January. Trilogue negotiations will start imminently. The ECB and the EBA have each expressed concern about a number of deviations in the proposals from the Basel standards, specifically that these leave pockets of risks unaddressed. These concerns relate in particular to transitional arrangements in relation to the implementation of the output floor leading to lower risk weights than those envisaged in the Basel standards in certain areas, several deviations under the SA for credit risk and the retention of exemptions relating to CVA risk.

The package contains policy proposals beyond Basel 3.1 implementation. These include ESG prudential requirements, discussed above, and proposals to provide stronger tools for supervisors overseeing EU banks. In particular; (i) a clear, robust and balanced "fit-and-proper" set of rules, where supervisors assess whether senior staff have the requisite skills and knowledge for managing a bank; (ii) better tools to oversee fintech groups, including bank subsidiaries; and (iii) proposals seeking to harmonise the authorisation and supervision of third country providers of financial services. Some of the proposals are particularly contentious and will remain the subject of much scrutiny throughout 2023. Please see our bulletin for further information on the third country entity proposals.

The Banking Package 2021 also included a separate legislative proposal to amend the Capital Requirements Regulation in the area of resolution (the so-called "daisy chain" proposal), discussed further below.

EU IFR/IFD

The EU's prudential regime for investment firms has been in place for slightly longer than in the UK so EU investment firms within scope should be slightly further ahead in their processes. For significant EU investment firms, however, Regulatory Technical Standards on the reclassification of investment firms as credit institutions in accordance with Article 8a (6)(b) of Directive 2013/36/EU remain outstanding.

The Investment Firms Directive (IFD) amended the Capital Requirements Directive (CRD) by introducing Article 8a regarding specific requirements for the authorisation of significant investment firms as credit institutions. The EBA is mandated to develop draft RTS to specify the methodology for calculating the thresholds referred to in paragraph 1 of Article 8a of the CRD. The EBA published its final report and draft RTS in December 2021 but the draft RTS include a group asset test which the EBA describe as "neutral with regards to geographical limitations". This approach caused concern, particularly amongst third country groups.

As part of the European Council's agreed negotiating position in relation to the MiFID review, it proposes to amend Article 8a of the CRD to specify that the group asset test applies to consolidated assets of all undertakings in the group that are established in the EU.

Meanwhile, the EBA advised competent authorities in July 2021 to apply a pragmatic approach for those investment firms, where the relevant EUR30bn threshold for the identification of the prudential regime to be applied to the investment firm cannot be determined without the guidance provided in the EBA RTS. More specifically, the EBA advised supervisors not to prioritise any supervisory or enforcement action in relation to the identification of investments firms, until six months after the final methodology is in place.

UK "competitveness" changes

In addition to the Basel 3.1 reforms, HM Treasury is also considering competitiveness changes to the existing prudential regime currently contained in onshored EU legislation. In particular, in relation to the prudential treatment of overseas exchanges and the process by which they are "recognised exchanges" under the CRR, HMT proposes to (i) add a link to the ROIE regime as part of the definition of recognised exchanges; and (ii) set out that firms covered in the definition of recognised exchanges are either those detailed in the PRA's regulatory technical standards which accompany the definition of recognised exchanges or are those subject to the ROIEs regime. Exchanges from UK equivalent regimes are meant to be captured in the PRA's technical standards list, while individual exchanges that choose to apply, and are granted access under the ROIEs regime are approved and confirmed by the FCA.

The UK announced in September 2022 its intention to scrap the cap on bankers' bonuses, with the aim of attracting more banks and bankers to the UK. The PRA and FCA published a joint consultation on proposed changes to the current requirements concerning the ratio between fixed and variable components of total remuneration in December 2022 which will close on 31 March 2023.

UK Strong and Simple Regime

The PRA is also continuing its work on developing a 'strong and simple' prudential framework for PRA-regulated banks and building societies that are neither systemically important nor internationally active. The PRA consulted in 2022 on the scope of the regime and is currently considering whether the proposed revised approaches for credit risk SA and credit risk mitigation in CP 16/22 on the implementation of Basel 3.1 would be the appropriate starting point for designing the simpler regime's risk-based capital framework. The PRA has stated that the development of this new regime will be a multi-year initiative and further consultation papers will follow during 2023 and 2024. Banks which qualify for the strong and simple regime will not be required to implement the Basel 3.1 reforms.

UK IFPR

Solo authorised UK investment firms now have a full year of the new prudential regime, the "IFPR" under their belt. 2023 will see the first firm public disclosures under this new regime. Similarly, such MiFIDPRU firms will conclude their first performance periods subject to the IFPR's remuneration requirements.

Recovery and resolution

UK mid-tier banks are expected to comply with end-state MREL obligations and resolvability assessment requirements by 1 January 2023 whilst the largest firms embark upon their second Recovery Assessment Framework cycle, with their second assessment reports due by 6 October.

Internal MREL/TLAC regime

Following the UK's departure from the EU, the UK government does not consider there to be a clear rationale for retaining the fixed 90% requirement for internal MREL and so proposes to delete Article 92b of the CRR via secondary legislation, using powers contained within the FSM Bill.

The government considers that the FSB's standards for setting internal loss absorbing capacity will instead be effectively implemented through the Bank of England's established MREL framework, without the need for any further legislation. Under the framework, the Bank is able to exercise its discretion to set internal capital and subordinated debt requirements as it judges appropriate for the purposes of meeting the statutory objectives of the special resolution regime (including financial stability). The UK government expects the Bank will do so in line with the FSB standards.

The government intends to consult fully on the future of the remainder of the onshored CRR TLAC regime in due course.

Solvent wind down of trading activities

In May 2022, the PRA finalised its expectations of firms in relation to the full or partial orderly wind-down of trading activities in recovery and post resolution restructuring. Firms are expected to meet the expectations by 3 March 2025 but the PRA is in dialogue with firms to ensure that they are making adequate preparations significantly in advance of the implementation date and have oversight of progress to implementation.

Changes to depositor protection rules for safeguarding accounts

In September 2022, the PRA issued a consultation on proposals to amend the Depositor Protection Part of the PRA Rulebook, to delete the Dormant Account Scheme Part of the PRA Rulebook, and make minor amendments to the PRA's Supervisory Statement 18/15 on 'Depositor and dormant account protection', the PRA's Statement of Policy on 'Deposit Guarantee Schemes', and the PRA's SoP on 'Calculating Risk-Based Levies for the Financial Services Compensation Scheme deposits class'. The PRA's continuity of access rules and dormant account section were subsequently deleted in December 2022.

Other aspects of the consultation were considered more complex and as such, subject to a longer consultation. These aspects included proposals to (i) confirm that a trust can hold monies that fall within the scope of the temporary high balance (THB) regime and set out when a joint account holder is entitled to THB; (ii) protect eligible customers of e-money institutions, authorised payment institutions, small payment institutions, and credit unions (in respect of e-money), if a credit institution holding such firms' safeguarded funds were to fail; (iii) set out that depositors of overseas firms that have their Part 4A permission removed and exit the UK market do not continue to benefit from Financial Services Compensation Scheme (FSCS) protection; (iv) provide that depositors only have a right of withdrawal, without penalty, when a deposit taker merges with or transfers their deposits to another deposit taker, if the operation results in a reduction in FSCS protection; and (v) confirm that the annual FSCS notification requirement for depositors does not apply to depositors that are not entitled to FSCS protection by virtue of their legal personality. The PRA is currently considering feedback to its consultation and will issue a policy statement "in due course".

The SRB's focus for 2023, the final year of its Multi-Annual Programme for 2021-2023 will be on achieving resolvability of SRB entities and less significant institutions, fostering a robust resolution framework, carrying out effective crisis management, operationalising the Single Resolution Fund, and targeting improvements to areas such as IT and organisational structure. All banks and credit institutions under the SRB remit are expected to be resolvable and compliant with the Expectations for Banks (EfB), as well as achieve the final individual banks' MREL targets. Less Significant Institutions, under the remit of the National Resolution Authorities (NRAs), are also expected to become resolvable along a similar timeline.

2023 will also mark the final year for the constitution of the Single Resolution Fund, which by the end of the year is expected to reach at least 1% of covered deposits in all participating Member States, and be fully mutualised.

Internal MREL

The EC's Banking Package 2021 discussed above also included a number of proposed changes to the EU's bank resolution framework. These 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"). Political agreement on this particular aspect of the package was reached in April 2022 and Regulation 2022/2036 was published in the Official Journal in October 2022. The Regulation makes a number of changes to the Bank Recovery and Resolution Directive which member states are required to transpose by 15 November 2023.

Crisis management and deposit insurance

The European Commission's review of the EU bank crisis management and deposit insurance framework remains ongoing. The Commission is evaluating the BRRD, SRM Regulation and the DGSD and seeking to address issues concerning the establishment of the European Deposit Insurance Scheme (EDIS). The Commission held two consultations in 2021: a targeted consultation published in January 2021 and a public consultation published in February 2021. A recently published agenda of possible items for college agendas suggests that the Commission intends to adopt legislative proposals relating to the CMDI framework review on 8 March 2023.

Outsourcing and operational resilience

UK

Operational resilience remains a priority for the UK's regulators and current market and geopolitical events have intensified that focus.

Firms will have identified their important business services, set impact tolerances and identified vulnerabilities under the framework published by the FCA and PRA in March 2021. Firms are now within a 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 by no later than March 2025.

The FCA, PRA and Bank of England also plan to consult on operational incident reporting requirements for firms and financial market infrastructures.

The resilience of third party services providers deemed critical to the financial services market is also an area of focus for the legislators and regulators. Following publication of a policy statement by HM Treasury in March 2022, the FSM Bill establishes a new framework for regulating critical third parties. The UK regulators published a joint discussion paper on how they could use their proposed powers in July 2022 which closed for comment in December 2022. Give the regulators' focus on operation resilience, we are likely to see further policy in this area and possibly even the designation of certain services providers as "critical third parties" in 2023, after the FSM Bill is enacted.

EU

On 16 January 2023, the Digital Operational Resilience Act (DORA) entered into force. It will apply from 17 January 2025 and aims to harmonise provisions relating to digital operational resilience across the EU financial sector. DORA also aims to raise awareness of ICT risks, acknowledging that ICT incidents and a lack of operational resilience have the possibility to jeopardise the soundness of financial entities and of the financial sector.

Throughout 2023 and early 2024, the ESAs will be consulting on technical standards covering, by way of example, the criteria for classification of major ICT-related incidents and significant cyber threats, the content of policies on the use of ICT services concerning critical or important functions, the register of information in relation to all contractual arrangements on the use of ICT services provided by ICT third–party service providers, and the content and timings of major ICT-related incident reports and notifications.

It should also be noted that critical providers not established within the EU that provide IT services to financial entities in the EU will be required to establish an EU subsidiary by 17 January 2025. Critical third-party providers of ICT services that are part of a group, are expected to designate a legal person as the coordination point in order to ensure adequate representation and communication with the main supervisor.

AML/Financial crime

AMLD

The sixth Directive on AML/CFT (AMLD6) continues through the legislative process. Once in force and applicable, it will replace the existing Directive 2015/849 (the fourth AMLD, as amended by AMLD5). On 7 December 2022, the Council agreed its position, which paves the way to trilogue negotiations with the Parliament to agree a final version of the Directive.

On 22 November 2022, the European Court of Justice issued a decision that invalidates a provision of the current anti-money laundering directive that requires information on the beneficial owners of corporate and other legal entities established in the EU to be made accessible to the public. The Court decided that such public access to personal information constitutes a "serious interference with the fundamental rights to respect for private life and to the protection of personal data" which "is neither limited to what is strictly necessary nor proportionate to the objective pursued".

The decision has direct effect, which means that public authorities and national courts need to abide by the conclusions of the Court. A number of European countries have suspended the public access to registers of beneficial owners. The decision does not, however, impact rules on the creation of registers of beneficial owners or relieve those in scope of their obligations to identify and verify the identity of their clients' beneficial owners. The AMLD should now be amended to reflect the Court's decision.

Political negotiations are also ongoing in the EU concerning the Regulation establishing the Authority for AML/CFT (AMLA Regulation) and the Regulation on anti-money laundering and counter terrorism financing with publication in the official journal of both anticipated in 2023.

Economic Crime and Corporate Transparency Bill 2022

The Economic Crime and Corporate Transparency Bill (the Bill) proposes various reforms designed to reduce economic and financial crime in the UK and is currently progressing through Parliament.

Some of the proposals in the Bill include (i) a range of substantial new or expanded powers for regulators and law enforcement to combat money laundering and economic crime, (ii) codifying new criminal offences related to designated persons under the UK sanctions regime and providing false information to Companies House and (iii) granting additional powers to law enforcement so they are able to seize and recover cryptoassets more quickly and easily.

The Bill was laid before Parliament on 22 September 2022. The Bill had its last committee debate in the Commons on 29 November 2022 and has now moved into the Report Stage, the date of which is yet to be announced. However, Companies House has indicated that it expects the Bill to become law in the spring of 2023.

The Bill follows on from the Economic Crime (Transparency and Enforcement) Act (the Act) that passed last year. The Act introduced the Register of Overseas Entities, strict liability for breaches of financial sanctions and enhancements to the 'Unexplained Wealth Order' regime, amongst other things.

UK carrying out targeted review of AML and CTF regime

In May 2022, FATF published a follow-up report analysing the UK's progress in addressing the technical compliance deficiencies identified in the mutual evaluation report (MER) of the UK from 2018. In June 2022, the UK Government published a report reflecting on the UK's progress since the 2018 MER and setting out further actions to improve in some of the areas highlighted by the FATF.

The report sets out proposals for a stronger framework to measure the effectiveness of the MLRs. This includes an overall objective for the UK's AML regime and primary and secondary objectives of the MLRs. The proposals also include a commitment to developing a revised set of priority metrics as part of the Economic Crime and Corporate Transparency Bill.

In December 2022, HM Treasury published its AML and CTF supervision report 2020-22. The report provides information about the performance of the UK's AML/CFT supervisors between 6 April 2020 and the 5 April 2022. The report confirmed that the FCA issued seven fines under the MLRs and FSMA for a total sum of over GBP500 million and brought its first criminal prosecution of a regulated firm under the MLRs. The FCA currently has 38 AML investigations open, and 75 investigations open into suspicions of insider dealing, as well as submitting over 650 SARs to the National Crime Agency during the reporting period. The report also hints at further developments in the second economic crime plan, which will be published in 2023.

Regulation 5 of the Money Laundering and Terrorist Financing (Amendment) (No 2) Regulations 2022 (SI 2022/860)

Regulation 5 introduces a new Part 7A into the MLRs, which extends the 'travel rule' to cryptoasset transfers. The travel rule is an existing requirement for financial institutions to share identifying information about the sender and recipient (payer and payee) of a wire transfer, in the payment message. This change aims to bring the UK in line with the FATF Recommendation 16, regarding information sharing requirements for transferring cryptoassets.

Only one of the originator's address, date of birth, or passport number will need to be sent with a cross-border transaction above the de minimis threshold of EUR1,000 (including aggregate transactions of crypto and fiat currencies). Where an intermediary is involved, the travel rule applies to cryptoasset exchange providers, custodian wallet providers and sub-custodians but not to intermediaries such as software providers.

The Treasury has decided to allow a 12-month grace period, to run from the point at which the MLRs take effect until 1 September 2023, during which time crypto businesses will be expected to implement solutions to enable compliance with the travel rule.

The first payments for the Economic Crime (Anti-Money Laundering) Levy Regulations 2022 are due in the financial year 1 April 2023-31 March 2024

The UK Government has introduced an Economic Crime (Anti-Money Laundering) Levy (the levy) on entities that are regulated for AML purposes. The levy will be charged on those entities that are regulated during the financial year from 1 April 2022 to 31 March 2023. The Government intends for the levy to raise about GBP100m a year to help fund new government action to tackle money laundering and help deliver the reforms committed to in the 2019 Economic Crime Plan.

The levy will be paid as a fixed fee which will be determined by reference to the entity's size based on their UK revenue. All AML-regulated entities with UK revenue over GBP10.2m will be subject to the levy. Medium-sized entities will pay GBP10,000; large entities GBP36,000; and very large entities GBP250,000. The levy will apply on an entity-by-entity basis, rather than a group basis.

The first payments will be made in the financial year starting on 1 April 2023. His Majesty's Revenue and Customs (HMRC), the FCA and the Gambling Commission will collect the levy. Entities will be required to pay their levy charge within six months of the end of the levy year (ie by 30 September 2023). However, the collectors will be able to require entities to pay in advance of this date, within reason, if this aligns with their existing fee processes.

Financial markets

MIFID/MiFIR

Wholesale Markets Review

The FSM Bill takes forward the outcomes of the Wholesale Markets Review (WMR), with the aim of removing restrictions on trading in wholesale markets and to promote investments. The FSM Bill will make amendments to UK MiFIR, including: (i) replacing the pre-trade transparency waiver regime; (ii) stripping away the double volume cap; (iii) removing the share trading obligation; (iv) aligning the derivatives trading obligation (DTO) with the clearing obligation under UK EMIR; (v) exempting post-trade risk reduction services from the DTO; (vi) giving the FCA a permanent power to modify or suspend the DTO; (vii) simplifying the transparency regime for fixed income and derivatives; (viii) simplifying the position limits regime; (ix) changing the definition of a systematic internaliser; and (x) removing restrictions on midpoint crossing for trades.

FCA to finalise the guidance and publish policy statement on guidance on trading venue perimeter

On 22 September 2022, the FCA published a consultation paper on proposed guidance on the regulatory perimeter for multilateral trading facilities and on possible future changes to smaller trading venues' regulatory obligations.

Many respondents to the WMR of 2021 felt the trading venue framework did not make sufficient distinction between bilateral and multilateral trading. As part of the new guidance, the FCA intends to clarify which types of activities will constitute a multilateral system that will require authorisation as a trading venue.

The FCA also plans to publish Q&As in the Perimeter Guidance manual (PERG) on the application of the general guidance to specific types of arrangements covering voice brokers, internal matching systems, primary market platforms, bulletin boards and blocking trades onto regulated trading venues. In particular, it has stated that that Q&As 7, 10, 11 and 12 in Section 5 of the ESMA market structures Q&As should not form part of its supervisory expectations once its final guidance has been published.

This could be an indication of the FCA's attempts to move away from the EU's approach to regulation and could see a possible divergence in approach between the FCA and ESMA on trading venue perimeters in 2023 and beyond.

The FCA's consultation on the trading venue perimeter guidance closed on 11 November 2022. The draft guidance, and a policy statement, will be published in the second quarter of 2023.

MiFID Review

The EU's review of MiFID is ongoing following publication in November 2021, of the European Commission's suggested changes to MiFIR and MiFID II as part of its Capital Markets Union reform package.

Key changes include: (i) adjustments to the scope of the STO and DTO; (ii) possible prohibition of payment-for-order-flow; (iii) targeted changes to the equities and non-equities pre-trade and post-trade transparency regimes; (iv) standardisation of (and access to) market data through consolidated tape providers for different asset classes; (v) deletion of the RTS27 best execution reporting requirement; and (vi) deletion of the licensing requirement for persons dealing on own account on a trading venue by means of DEA.

The Council of the EU agreed its negotiating mandate to start negotiations with the EP in relation to the package in December 2022. Political negotiations are expected to conclude and the amendments published during the course of 2023.

ESMA expects to publish a final report on the reviewed guidelines on MiFID II product governance guidelines

On 8 July 2022, ESMA published a consultation paper on the review of the 2017 Guidelines on MiFID II product governance requirements. ESMA is proposing to update the guidelines following a number of recent regulatory and supervisory developments, including the European Commission's Capital Markets Recovery Package and subsequent Amending Directive, sustainability-related amendments to the MiFID II Delegated Directive, recommendations on the product governance guidelines by ESMA's Advisory Committee on Proportionality and findings of ESMA's 2021 Common Supervisory Action (CSA) on product governance.

In particular, the results of the CSA showed that while firms do define a target market, the definition of a target market is approached as a tick box exercise and is not completed with sufficiently clearly defined terms. Additionally, a firm's definition of a target market does not necessarily correlate to the distribution strategy applied by firms

Accordingly, the main proposals in the draft guidelines relate to (i) firms identifying sustainability-related objectives as part of their target market assessment, (ii) the practice of identifying a target market for a cluster of products with sufficiently comparable characteristics and risk features, (iii) the determination of a compatible distribution strategy where a distributor considers that a more complex product can be distributed under non-advised sales and (iv) the periodic review of products, including the application of the proportionality principle.

The consultation closed on 7 October 2022 and ESMA expects to publish the final report in the first quarter of 2023.

MAR

ESMA will consider responses to its call for evidence on the practice of pre-hedging to help it develop appropriate guidance in this area

On 29 July 2022, ESMA published a call for evidence on pre-hedging to help it to develop appropriate guidance. In its final report on the Market Abuse Regulation (596/2014) (MAR) Review, ESMA acknowledged that there are fundamentally different views on pre-hedging.

Whereas some market participants see pre-hedging as being essential for risk management and the correct functioning of markets, others consider that pre-hedging may amount to insider dealing if a broker were to use the information received from the client to make trades for its own account, including potentially trades against the client.

Several market participants asked ESMA to issue guidance on what could be considered as MAR-compliant in terms of pre-hedging activities, and what behaviour might constitute frontrunning. Some market participants also asked for guidance on procedural aspects of pre-hedging, such as the documentation required, transparency regarding pre-hedging arrangements by brokers to their clients, and internal policies of market makers.

The call for evidence closed on 30 September 2022 and the conclusions are yet to be published. Given that the practice of pre-hedging is not defined in EU law and there was such a mixed response on the appropriateness of pre-hedging, it will be interesting to see what areas of consensus emerge, if any.

Listing Act reforms

On 7 December 2022, the European Commission introduced its proposal for the new Listing Act Package, which includes significant amendments to the EU MAR.

The Listing Act narrows the scope of the disclosure obligations set out in Article 17(1) of the MAR in the case of inside information in relation to so-called "protracted processes".

The Commission proposes that the disclosure obligation does not cover the intermediate steps of the process and the inside information would only need to be disclosed once it consists of an event that is intended to complete a protracted process.

Another part of the proposal includes new explicit criteria to the requirement set out in Article 17(4) of the MAR that the disclosure of inside information may be delayed provided that the delay is not likely to mislead the public. Such conditions include (i) the inside information must not be materially different from the previous public announcement of the issuer; (ii) the inside information does not regard the fact that the issuer's financial objectives are not likely to be met, where such objectives were previously announced; and (iii) the inside information is not in contrast with the market's expectations.

Article 18 of the MAR is amended to introduce a lighter regime of drawing up and maintaining insider lists by issuers; listed companies would have the obligation to draft a permanent insider list instead of a project-specific insider list. Finally, Article 19 of the MAR is amended to raise the annual threshold above which transactions conducted by Persons Discharging Managerial Responsibilities (PDMRs) and Persons Closely Associated (PCAs) must be notified to the issuer and to the competent authorities from EUR 5,000 to EUR 20,000. The proposal would also empower the national competent authorities to raise the said limit to EUR 50,000 on a national level and authorize an issuer to allow any person discharging managerial responsibilities within it to trade or to make transactions on its own account or for the account of a third party during a closed period.

The feedback period for the Commission's proposal is currently open and ends on 28 March 2023. The legislative proposals will then be submitted to the European Parliament and the Council for adoption, where they will be scrutinised and, no doubt, amended. As such, it is unlikely that we will see any binding rules on this issue until late into 2024.

EMIR 3.0

In December 2022, the EU Commission published its EMIR 3 proposal. A key aim of the proposal, as stated by the EU Commission, is to encourage clearing in the EU, enhance the attractiveness of EU CCPs and reduce the excessive reliance of EU market participants on non-EU CCPs. The EU Commission has previously expressed concerns about the possible financial stability risks associated with the excessive reliance on non-EU CCPs, particularly those based in the UK. Proposed changes include a new "active account" requirement for entities clearing certain types of derivatives contracts to clear a certain proportion of those contracts via an EU authorised CCP as well as a new requirement to inform clients about the possibility of clearing at an EU CCP and to report the scope of clearing undertaken.

The proposal additionally outlines a number of other changes relevant for counterparties trading OTC derivatives. These include (without limitation):

(i) amendments relating to counterparty classification (including changes to the types of contract that will count towards the clearing thresholds, a mechanism for ESMA to periodically review and amend clearing threshold levels and, in the context of the clearing threshold for non-financial counterparties, the removal of the group test and a mandate for ESMA to review the hedging exemption);

(ii) the removal of the Article 13 equivalence requirement (which may impact, amongst other things, cross-border intragroup exemptions for margin and clearing and the ability to rely on Article 13 equivalence in the context of risk mitigation requirements);

(iii) the introduction of a phase-in period when a non-financial counterparty becomes subject to margin requirements for the first time;

(iv) the removal of the requirement for regulatory technical standards relating to initial margin model governance requirements;

(v) the removal of the intragroup exemption for reporting;

(vi) amendments to the clearing exemption for pension schemes;

(vii) transparency requirements for clearing members and clients providing clearing services to ensure that clients and indirect clients have better visibility and predictability of margin calls; and

(viii) the exclusion of intragroup transactions from capital requirements for CVA risk.

There are also a number of proposed changes aimed at making it more attractive to clear in the EU which relate specifically to CCPs. The proposal will now be subject to the ordinary legislative procedure, with negotiation expected to begin in the European Parliament and the Council of the European Union early this year. However, the legislative process may take some time to unfold over 2023 and 2024 and may not enter into force until 2025 (although this timing is by no means certain).

The UK's review of EMIR will fall part of the repeal and review process under the FSM Bill. As yet, we have no information about the scheduling of the review of EMIR. It has not been identified within either tranche 1 or tranche 2 of the reforms.

UK CCP/CSD Regulation

The FSM Bill establishes a new framework for the Bank of England's regulation of Financial Market Infrastructure (FMI) and in particular central counterparties (CCPs) and central securities depositories (CSDs). The FSM Bill furthers the move to a model of regulation established by the Financial Services and Markets Act 2000 (FSMA), where the setting of regulatory and technical standards is delegated to expert regulators. In this model, the regulators' day to day experience of supervising financial services firms is central to the regulatory policy making process and provides flexibility for the regulators to update standards efficiently. The 'FSMA model' will revoke the relevant retained EU legislation and replace it with the regulator's rules.

In certain circumstances, the Bank will be able to apply its rules not just to UK CCPs and CSDs but also to third country CCPs and CSDs. The FSM Bill introduces a definition of a "systemic third country CCP" – any third country central counterparty that the Bank has determined is systemically important or is likely to become systemically important to the financial stability of the UK. The criteria for determining systemic importance will be set out by HMT in secondary legislation.

The FSM Bill introduces a Senior Manager and Certification Regime (SMCR) framework for CCPs and CSDs that is similar to the existing SMCR for banks, insurers and other authorised persons. RIEs are also within scope of the framework and the FSM Bill gives HMT the power to apply the regime to credit rating agencies. The government will be able to decide when to apply the regime to any of the entity types and to tailor the regime to each type.

Given the systemic importance of the FMI and the international standards in this area, we are unlikely to see a UK bonfire of regulation in this space. Whilst the UK's CCPs and CSDs will of course take great interest in these parts of the FSM Bill in 2023, third country FMI should consider the implications for them too. In 2023 participants of CSDs and CCPs will also be keen to understand the practical implications of this new framework on them and their access to and cost of services. FMI firms and their senior managers will be keen to engage in consultations in 2023 around the scope of the SMCR and conduct rules. Although it may be premature for such firms to prepare for practical implementation of the SMCR at the beginning of 2023, it is not too soon to think ahead and try to shape the detail of the final regime appropriately. The detail around the regime is likely to be influenced by the outcome of HMT's call for evidence on legislative framework of SMCR and the FCA/PRA review of regulatory frameworks for the SMCR anticipated in Q1 of 2023.

UK Edinburgh Reforms – Consolidated Tape

The Government plans to work with the FCA to have a regulatory regime in place by 2024 to support a consolidated tape for market data. This will bring together market data from multiple platforms into one continuous feed. A consolidated tape could enhance market transparency, efficiency, and competition, lower costs for firms and investors, and make UK markets more attractive and competitive.

This reform comes off the back of MiFID II, which proposed the creation of a consolidated tape to provide consolidated data on prices and volume of traded securities in the EU, thereby improving overall price transparency across trading venues.

UK Edinburgh Reforms – Investment Research

The Government plans to launch an independent review into investment research and its contribution to the effectiveness of UK capital markets. This forms part of the Government's wider commitment to enhance the UK's ability to attract listings.

The review will look at the effects of the EU's MiFID unbundling rules. Under MiFID II, asset managers were no longer allowed to "bundle" payment for research with the trading commissions charged to their funds. Instead, most opted to pay directly out of their own profits. This led to a big fall in spending on third-party research.

As such, it could be argued that the rules have hurt UK asset managers relative to their rivals based in the US, where the old commission-based payment system has been retained – although the SEC's No-Action Relief in this regard expires on 3 July 2023. Thus, it will be interesting to see whether changes to the rules in this area could reduce the regulatory burden on firms and provide for greater flexibility for the purchase of investment research in the UK.

UK Edinburgh Reforms – Accelerated Settlement

The Government has established a new industry-led Accelerated Settlement Taskforce to examine the case for trades to be settled more quickly in the UK, from the current industry standard of two days. There are ongoing discussions about whether a shortening to "same-day" settlement is possible or desirable in the future (potentially with the aid of innovations such as distributed ledger technology).

Objectives of the taskforce include the following: (i) exploring the case for moving to an accelerated settlement cycle, such as "T+1", in the UK, and outlining how this could be implemented; (ii) evaluating current settlement performance across the UK sector and assessing potential improvements and reforms; and (iii) providing recommendations, including how any changes should be implemented by industry, regulators and government and what the appropriate timetable should be.

The Chair of the Taskforce is to provide an interim public report on the Taskforce's initial findings by December 2023, with a full report with recommendations by December 2024. These recommendations could include actions for government, the UK financial services regulators and industry participants.

Payment services and payment systems

With the ongoing emergence of new payment services and risks, the payment frameworks in both the UK and EU are currently under review. Fraud prevention is also a key focus area.

Payment Services Regulations review and call for evidence

On 13 January 2023, HMT published a review and call for evidence on the Payment Services Regulations 2017 (PSRs). In the review, HMT found that the PSRs have fostered a strong, innovative and competitive UK payment sector that ensures adequate consumer protection. However, in isolation they have not gone far enough. The review also found that the framework fails to keep pace with market developments, such as the emergence of cryptoassets. The areas proposed for reform include the safeguarding regime – HMT invites the FCA to consult on this later in 2023 - consumer protection, execution times, fraud prevention (strong customer authentication and authorised push payment scams), access to payment accounts and systems, and convergence of the e-money and payments regimes. Alongside the review, HMT published a call for evidence, focusing on how UK payments regulation should evolve to meet the government's aims and address the specific challenges highlighted in the review. It also seeks evidence on the Electronic Money Regulations 2011 and the Cross Border Payments Regulation. The call for evidence closes on 7 April 2023. The UK government intends to arrange for a review of the Payment and Electronic Money Institution Insolvency Regulations in due course.

PSR market reviews into card fees

The PSR is carrying out two market reviews into card fees – one on card scheme and processing fees and one on cross-border interchange fees. The market review of card scheme and processing fees looks in detail at the levels, structure and types of scheme and processing fees. The PSR expects to publish a report setting out its interim conclusions on card scheme and processing fees in Q4 of 2023 and a final report, which would include any proposed remedies in Q2 of 2024. The PSR's second market review focuses on consumer cross-border interchange fees between the UK and the EEA. The PSR wants to understand the reason behind the increase in fees associated with some UK-EEA payments, as well as to engage with businesses to better understand how the increases are impacting them. The PSR expects to publish a report setting out its interim conclusions on UK-EEA consumer cross-border interchange fees by Q3 of 2023 and its final report in Q4 of 2023.

PSR Confirmation of Payee

The PSR has confirmed the extension of the fraud protection measure, Confirmation of Payee (CoP), to a further 400 payment service providers (PSPs). The CoP service is designed to prevent accidentally misdirected payments and APP scams by checking the name of the account holder with the account number and sort code. The policy has been implemented through Specific Direction 17, which splits the PSPs into two implementation groups: (i) Group 1 PSPs, which are larger and/or more complex, must have and use a CoP system with send and respond capability after 31 October 2023; and (ii) Group 2 PSPs, which includes all other PSPs that use unique sort codes, or are building societies using an SRD reference type, must have and use a CoP system with send and respond CoP capability after 31 October 2024.

PSR mandatory reimbursement for APP fraud

The PSR is looking to implement mandatory reimbursement and cost allocation for authorised push payment (APP) scams. Its proposals relate to measures to require reimbursement for APP scams, improve the level of protection for APP scam victims, and incentivise payment service providers (PSPs) to prevent APP scams, whether as a sending PSP or a receiving PSP. In the context of mandatory reimbursement, the PSR is proposing requiring all PSPs sending payments over Faster Payments to fully reimburse APP scam victims, with only limited exceptions. The sending PSP will have to reimburse the victim as soon as possible, and no more than 48 hours from the fraud being reported. If the PSP has evidence or reasonable grounds for suspicion of either first party fraud or gross negligence, it will have more time to investigate and can delay the payment. The PSR is also proposing to include all categories of APP scam in the rules on mandatory reimbursement. With regards to allocating the costs of reimbursement, the PSR is proposing to allocate the costs of reimbursement equally between sending and receiving PSPs. The deadline for responses was 25 November 2022, and the PSR is expected to set out its policy position and accompanying action in the first half of 2023.

HMT consultation and call for evidence on payments regulation and the systemic perimeter

In July 2022, HMT published a consultation and call for evidence on the government's approach to reforms to the payments regulatory landscape, including the systemic payments perimeter of the Bank of England. The consultation discusses the rationale for expanding the Bank of England's supervision of systemic risk relating to payments beyond payment systems and associated service providers, and the principles the government would apply to any reforms of the Bank of England's regulatory responsibility for systemic payments activities, namely that of 'same risk, same regulatory outcome'. The consultation also considers what an amended regulatory perimeter would involve for regulating risk end-to-end throughout the payment chain; what criteria would apply to recognising new entities; and the continued role for HMT in determining which entities fall within the systemic regulatory regime. The consultation closed on 11 October 2022, and the government will formally respond to the consultation in 2023.

European Commission review of PSD2

Last year, the European Commission launched its consultation to gather evidence for the review of the revised Payment Services Directive (PSD2). The PSD2 review consultation will inform the European Commission on the application and impact of PSD2, taking into consideration developments in the payment market, payment user needs and the need for possible amendments. The review aims to cover, among other things: (i) an assessment of risks stemming from unregulated payment services; (ii) a stocktaking of the impact of strong customer authentication (SCA) on the level of payment fraud; and (iii) an assessment of new business models based on sharing payment account data, such as payment initiation services and account information services. The European Commission intends to adopt any legislative proposal for amendments, if deemed appropriate, in Q1/Q2 2023. Following the launch of the consultation, in June 2022 the EBA responded to a call for advice from the European Commission on the review of PSD2. In its response, the EBA put forward more than 200 proposals, including merging the PSD2 with the Electronic Money Directive, clarifying the application of SCA and the transactions in scope, addressing concerns about authentication approaches, and adjusting the prudential requirements. It remains to be seen which proposals the European Commission will agree with and which direction it will take.

FinTech/Digital Assets

Digital Euro

On 5 April 2022, the European Commission published a call for evidence for an impact assessment on a digital euro for the EU. The initiative aims to establish the digital euro as a new form of central bank money issued next to banknotes and coins, and would also cover the essential aspects and key design functions of the digital euro that would enable the European Central Bank (ECB) to issue the digital euro. The Commission plans to adopt a legislative proposal on a digital euro in the second quarter of 2023. Following adoption of the Regulation, the European Central Bank/Eurosystem may issue the digital euro in line with its objectives and mandate.

MiCA and the adoption of DLT pilot

As part of its Digital Finance Strategy, the European Commission adopted, in September 2020, a package of proposed legislative measures to create a framework for the regulation of crypto-assets in the EU. This includes a proposal for a Regulation on markets in crypto-assets (known as MiCA). In summary, the MiCA proposal will establish a new EU legal framework for crypto-assets that are not covered by existing EU financial services legislation and introduce specific rules for stablecoins (which are divided into electronic money (e-money) tokens and asset-referenced tokens). The Council and Parliament reached provisional political agreement on the proposed MiCA Regulation on 30 June 2022.

The latest official text of the MiCA proposal is the provisional agreement resulting from institutional negotiations (PE737.216) published by the European Parliament on 5 October 2022. It is expected that MiCA will formally be adopted and enter into force in the first half of 2023. MiCA will apply from 18 months after entry into force although the rules for stablecoins will start to apply after 12 months.

On 2 June 2022, the Regulation on a pilot regime for market infrastructures based on distributed ledger technology (EU) 2022/858 ("DLT pilot regime") was published in the EU Official Journal. The DLT pilot regime provides a legal framework for the trading and settlement of transactions in "tokenised" securities (digital representations of traditional securities) that qualify as financial instruments within the meaning of the MiFID II Directive (2014/65/EU). The DLT pilot regime is effectively a safe sandbox which allows for some regulatory flexibility for companies (both authorised and unauthorised entities) to seek permission to test out solutions using distributed ledger technology (DLT). Applications for the regime can be submitted from 23 March 2023 and permissions will be granted for a period of up to 6 years. Article 16 of the DLT pilot scheme is to apply from 4 July 2023. By March 2026, the European Securities and Markets Authority (ESMA) will report on the success of the regime and recommend next steps.

Future UK financial services regulatory regime for cryptoassets

On 1 February 2023, HMT published its much anticipated consultation and call for evidence on the future financial services regulatory regime for cryptoassets. The consultation builds on previous HMT proposals, which focused on stablecoins and the financial promotion of cryptoassets. The proposals are centred on various cryptoasset activities, such as exchange, investment, custody and lending activities, all of which the government is intending to bring into the regulatory perimeter for financial services. For each activity, the consultation sets out key design features of the regime, covering themes such as authorisation rules – firms undertaking cryptoasset activities would need to be authorised under a new FSMA-based regime - prudential requirements, data reporting, consumer protection, location policy and operational resilience. The consultation paper also proposes regimes for a range of cross-cutting issues, which apply across cryptoasset activities and business models, including market abuse and cryptoasset issuance and disclosures. Within the same document, HMT also issued a call for evidence relating to the regulation of DeFI, certain other cryptoasset activities, and the integration of sustainability within the cryptoasset market. The deadline for comments is 30 April 2023. The government is looking to introduce a phased approach to the regulation of cryptoassets.

Please also see the Financial promotions and marketing section for the government's approach to cryptoasset financial promotions.

Digital pound

With the belief that 'public' money will become increasingly less useful and useable and of shrinking relevance to a large part of the population, HMT and the Bank of England are consulting on a UK retail central bank digital currency (CBDC). The digital pound would be issued by the Bank of England and could be used by households and businesses for everyday payments in-store and online. If introduced, it would be interchangeable with cash and bank deposits. The consultation paper offers insight into how a digital pound might work. A decision about whether to implement a digital pound will be taken around the middle of the decade, and will largely be based on future developments in money and payments. The earliest stage at which the digital pound could be launched would be the second half of the decade. The deadline for comments is 7 June 2023.

Property status of digital assets

On 28 July 2022, the Law Commission published a consultation examining how existing personal property law applies to digital assets (including crypto-tokens and crypto-assets). The consultation paper recognises that the unique qualities of digital assets mean that many do not fit easily into traditionally recognised private property law categories or definitions. The consultation paper argues that the law must go further to acknowledge the unique features of digital assets and provisionally proposes the explicit recognition of a "third" category of personal property distinct from things in possession and things in action, to be labelled "data objects". The paper provisionally concludes that crypto-tokens would satisfy the criteria of data objects. The consultation closed on 4 November 2022. The Law Commission plans to publish a final report with its law reform recommendations in 2023.

FMI Sandbox

The FSM Bill provides for the creation of FMI sandboxes in which HMT may make UK regulations which provide for the testing of FMI activities using developing technology or adopting new or different practices. The FMI sandbox powers are intended to be sufficiently flexible to enable different FMI sandboxes to test different technologies and practices for different entities and activities (such as DLT). The sandbox is intended to facilitate innovation whilst allowing HMT, regulators and industry to better understand the impact of new technologies and practices. Once the FMI sandbox has been in place for a period of time to be specified by HMT, HMT will be able to make permanent changes to legislation on the basis of lessons learned. It is expected that the FMI sandbox will be up and running in 2023. HMT will consider subsequently whether further consultation is needed with industry when making legislation permanent.

Asset management regulation

Cross border marketing

In December 2022, ESMA published a final report containing the draft technical standards on the notifications for cross-border marketing and cross-border management under the UCITS Directive and the AIFMD. The purpose of the ITS and RTS is to facilitate the notification process for cross-border marketing and management activities in relation to UCITS and AIFs. The draft technical standards have been submitted to the European Commission for adoption. The Commission has three months from submission, with the possibility to extend by one month, to take a decision on whether or not to adopt the ITS and RTS.

ELTIFs

The proposed Regulation amending the Regulation on European Long-Term Investment Funds (ELTIFs) is currently going through the legislative process and about to be finalised. The aim of the amendments proposed is to make ELTIFs more attractive and easier to invest in. It is expected to create significant opportunities for sponsors across the EU.

ELTIFs are alternative investments funds dedicated to long-term investments and the only alternative investments funds that can benefit from an EU marketing passport for both professional and retail investors. A number of restrictions and burdensome conditions in the initial ELTIF Regulation have hindered their development, despite a growing interest in recent years by sponsors in the EU and a strong appetite by retail investors for alternative investment funds. To overcome these barriers, the revised proposal relaxes eligible investment, diversification and borrowing requirements and even removes certain restrictions entirely for ELTIFs marketed only to professional investors. Marketing requirements applicable to ELTIFs targeting retail investors are also greatly simplified.

In terms of next steps, the final text is expected to be formally adopted in February or March 2023 and to take effect nine months after its publication in the official journal. Please see our Great Fund Insights: The European long-term investment fund (ELTIF) Review for more information.

MMF policy framework

In October 2021, the FSB published a final report on policy proposals to enhance MMF Resilience, the policy proposals form part of the FSB's work programme on non-bank financial intermediation and are intended to inform jurisdiction-specific reforms and any necessary adjustments to the policy recommendations for MMFs issued by IOSCO. In the report the FSB announced it would be working with IOSCO, to review the progress made by member jurisdictions in adopting reforms to enhance MMF resilience, which involves a stocktake to be completed by the end of 2023 of the measures adopted by FSB member jurisdictions, including their evidence-based explanation of the relevant MMF vulnerabilities and policy choices made. This stocktake will be followed up in 2026 with an assessment of the effectiveness of these measures in addressing risks to financial stability.

ESMA is due to publish updated guidelines on MMF stress testing in late 2023. This follows a consultation paper issued by ESMA on 31 January 2023 titled "On the review of the methodology included in the Guidelines on stress test scenarios under the MMF Regulation". The Commission may also wish to progress work on MMFs in 2023, following its issue of a "Targeted Consultation on the Functioning of the Money Market Fund Regulation" that closed in mid 2022, and an opinion from ESMA in February 2022 suggesting a number of changes to make MMFs more resilient. On 8 February 2023, ESMA published its inaugural market report on EU MMFs, noting that aggregate investments were close to EUR1.5 trillion.

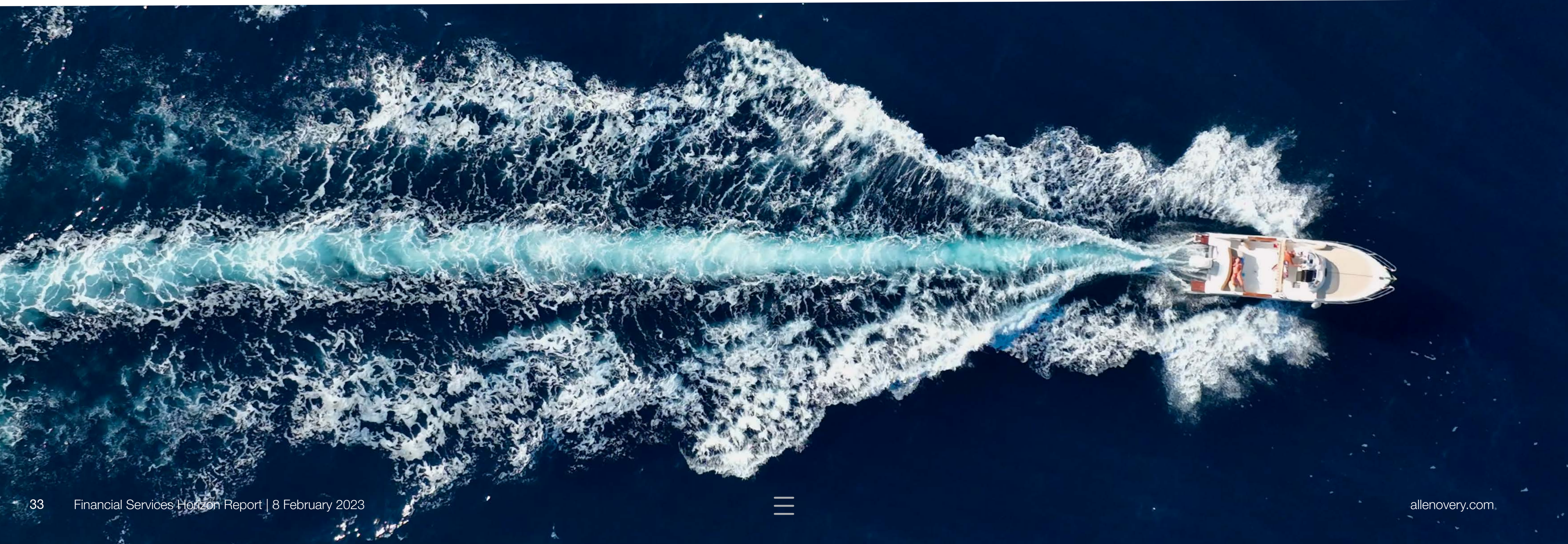
AIFMD and UCITS Directive Review

In November 2021, the European Commission published its legislative proposal following the AIFMD and UCITS Directive Review. The amendments to the AIFMD and UCITS Directive cover delegation and substance, liquidity risk management, loan origination, depositary functions, data reporting and supervisory convergence.

The Council of the EU agreed its general approach on the proposed Directive in June 2022 and on 24 January 2023, the European Parliament's Economic and Monetary Affairs Committee approved its final position. Trilogue negotiations are anticipated to commence in February/March with publication in the Official Journal of the EU likely to follow in the second half of 2023.

PRIIPs

The subject of PRIIPs continues to be fraught in the EU. A further set of ESAs PRIIPs Q&As is now expected in Q1 2023. And the long delayed (and overdue) review of the regime by the Commission may be finally set to occur, albeit wrapped up in a broader initiative – the Retail Investment Strategy, due in early 2023. This follows a report on PRIIPs from the ESAs recommending significant changes, encouraging the Commission to consider a broad review, and suggesting various ideas to bring the regime into the digital age.



UK

In February 2023, the FCA issued a "Dear CEO" letter for asset and fund managers, setting out its current supervisory strategy and highlighting risks of concern. Areas of focus included product governance and assessment of value, the new consumer duty, ESG/sustainable investing, product liquidity management, operational resilience, and financial resilience.

The FCA is expected to conduct a review in 2024 to assess how well the consumer duty has been embedded, with a focus on price and value. It is also expected to shortly publish the results of its review into firms' ESG oversight practices.

New Consumer Duty

The new consumer duty, is a significant regulatory initiative for the FCA, with far reaching implications for relevant firms. The FCA has made achieving improved outcomes for consumers a key regulatory priority in the coming years.

The regime comprises a new Principle for Businesses that will expressly require firms to "deliver good outcomes for retail customers" and which imposes a higher and more exacting standard of conduct than the existing Principles for Businesses (most notably, the existing treating customers fairly obligation in Principle 6). It also includes three cross-cutting rules to support the consumer principle by setting out expectations on culture and behaviour: to act in good faith, to avoid causing foreseeable harm to retail customers, and to support customers to pursue their financial objectives. Further rules are made in relation to four outcomes that focus on products and services, price and value, consumer understanding and consumer support. The regime will come into effect in phases, starting from 31 July 2023.

On top of this, the FCA set interim deadlines that firms should meet during the implementation period. Firms' boards were required to agree implementation plans by end October 2022. Product manufacturers are required to complete all reviews necessary for their existing products and services by the end of April 2023 so that they can share with distributors the information necessary for them to meet their new obligations under the duty. For more information see "New FCA Consumer Duty – What firms need to know".

On operational resilience, the FCA is proposing a range of proactive programmes to monitor and test firms' ability to meet the regulatory requirements.

Additionally, a number files relevant to the asset management sector are included in the Edinburgh Reforms. In particular, the list of tranche 2 files includes the Packaged Retail and Insurance-Based Investment Products Regulation, The Money Market Funds Regulation and, the Long-Term Investment Funds Regulation.

Long Term Asset Funds

The UK government is proposing to repeal the European Long-Term Investment Fund Regulation in favour of the UK's Long Term Asset Fund regime which is considered to provide a better fund structure for the UK Market.

The Long Term Asset Fund (LTAF) is a new type of authorised fund developed for use in the UK. Its 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. By a consultation paper issued in 2022, the FCA consulted on a proposal to broaden access to such funds to retail investors, subject to certain investor protections being in place. This consultation has now closed and the FCA is expected to publish a final policy statement and final rules in early 2023.

In parallel, in late 2022, the Productive Finance Working Group published a series of guides on the LTAF and a model instrument of incorporation. The FCA has also published guidance on valuation and pricing. Industry work on LTAFs is likely to be ongoing in 2023.

Overseas Funds Regime

Post Brexit, the UK government has taken measures to enable certain non-UK funds to be sold into the UK under a new regime known as the Overseas Funds Regime (OFR). In particular, this is intended to preserve the ability of EU UCITS managers to continue to sell EU UCITS funds to UK based retail clients. With Brexit, the UCITS passport under which this was previously done technically fell away, subject to an extension of time provided by the UK via the temporary permission regime.

The framework for OFR was introduced in 2021, among other things, via changes to FSMA. The FCA has now commenced some of the detailed work required to "operationalize" the regime. It has also commenced an equivalence assessment of the EU.

The FCA is expected to consult on new handbook rules for this purpose in 2023.

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