UPCOMING REGULATORY INITIATIVES IMPACTING PRIVATE FUND MANAGERS

Autumn 2022

Dechert
LLP

Table of Contents

Upcoming Regulatory Initiatives Impacting Private Fund Managers

Autumn 2022 / Authored by Karen Anderberg, Gus Black, Katie Carter, Jason Chan, Richard Frase, Christopher Gardner, Philippa List, Laurel Neale, Mikhaelle Schiappacasse, Mark Stapleton, Karen Stretch, Stanley Tiu, Lindsay Trapp, Michael Wong and Simon Wright.

INFORMATION CORRECT AS AT 6 SEPTEMBER 2022

THE YEAR SO FAR

2022 and global financial markets remain framed by the Russian war in Ukraine in February, which was denounced by the U.S., UK and EU. Since the start of the war, a variety of governments and supranational agencies around the globe have imposed multiple forms of sanctions against Russian and Belarussian individuals, assets and industries. The package of sanctions imposed by the EU includes targeted restrictive measures (individual sanctions), economic sanctions and diplomatic measures.

On 26 July 2022, the EU announced that it had decided to prolong by six months, until 31 January 2023, the restrictive measures targeting specific sectors of the Russian economy.[1] In the UK, the Financial Conduct Authority (**FCA**) has a webpage[2] on financial sanctions. It expects firms to have established systems and controls to counter the risk that they might be used to further financial crime, including systems to ensure compliance with financial sanctions obligations. Following a consultation (**CP22/8**)[3] on 6 July 2022, the FCA published a policy statement (**PS22/8**)[4] on rules to allow UK-authorised fund managers to make use of side pockets to address the potential harm caused by their Russian, Belarussian and Ukrainian exposures.[5] Sanctions continue to be a fast-moving area, and Dechert is available to advise on compliance with respect to sanctions and export controls across the EU, UK and U.S.

The Russian invasion of Ukraine and the sanctions applied to Russia and Belarus have resulted in sharp jumps in energy, food and metal commodities costs.[6] These increases have added to inflation pressures and the macroeconomic outlook looks increasingly uncertain. In addition to uncertainty arising out of the continuing Russian invasion and the end of more than a decade of low inflation and low interest rates, uncertainty related to the pandemic also continues, with lockdowns in major Chinese cities impacting Chinese growth and adding to global supply chain pressures. New COVID-19 variants also have the potential to cause further disruption.

The EU/UK post-Brexit regulatory landscape was again brought to the forefront of the markets' minds when on 20 July 2022, HM Treasury laid the Financial Services and Markets Bill 2022-2023 (the **Bill**) before Parliament for its first reading. (See 4.2 below "Financial Services Markets Bill 2022-23" for full details).

---

[1] A timeline of the EU's restrictive measures against Russia over Ukraine is available here.

[2] The FCA webpage is available here.

[3] CP22/8 is available here.

[4] PS 22/8 is available here

[5] The rules are set out in a specific instrument, the Collective Investment Schemes Sourcebook (Side Pockets) (Russia) Instrument 2022, available here, and came into force on 11 July 2022.

[6] ESMA notes in its "Report on Trends, Risks and Vulnerabilities No. 2, 2022" (dated 1 September 2022), available here, that the price of natural gas saw peaks in March (nine times its three-year average) and at the end of June amid renewed supply concerns (six times its three-year average).

1. ESG

Environmental, social and governance (**ESG**) factors are a key discussion point in the asset management industry, with many managers now incorporating (either voluntarily, or as a legal requirement) ESG considerations into their investment processes. In the EU, the impetus stems primarily from the EU Sustainable Finance Action plan.

2021 saw the advent of the Sustainable Finance Disclosure Regulation[7] (**SFDR**) and the Taxonomy Regulation.[8] These impact "Financial Market Participants" (**FMPs**) (which include AIFMs, UCITS ManCos and Portfolio Managers/Advisors) in relation to Financial Products (which include AIFs, UCITS and segregated investment management mandates).

The SFDR, which took effect on 10 March 2021, impacts both firms and products and requires three types of disclosure – pre-contractual disclosure, website disclosure and periodic reporting. It requires FMPs to make significant changes to their pre-March 2021 processes. The nature of the disclosures and reporting required depend on whether the Financial Product promotes environmental or social characteristics (Article 8 products), has a sustainable investment objective (Article 9 products), or does not fall into either the Article 8 or Article 9 category of Financial Product (Article 6 products).

The SFDR, as amended by the Taxonomy Regulation, requires the European Supervisory Authorities (**ESAs**) to prepare level 2 regulatory technical standards (**RTS**). A delegated act comprising all the various RTS required under the SFDR was adopted and published by the EU Commission on 6 April 2022.[9] Following a period of scrutiny by the European Parliament and Council of Europe (**Council**), the final RTS – Commission Delegated Regulation (EU) 2022/1288[10] – were published in the Official Journal of the EU (**OJ**) on 25 July 2022. As was anticipated, the RTS will apply from 1 January 2023.[11]

Although the date of application is 1 January 2023, the recitals to the RTS confirm that it is necessary for FMPs to have considered principal adverse impacts (**PAI**) of investment decisions on sustainability factors[12] by 31 December 2022, and to publish the information on those impacts by 30 June 2023. More importantly, the recitals state the first reference period for this reporting under the RTS will be 1 January 2022 to 31 December 2022, namely a period falling prior to the effective date of the RTS.

Notwithstanding that the RTS are not yet in force, on 6 May 2022 the ESAs announced that they had received a letter from the EU Commission (dated 11 April 2022) mandating them to undertake a review of, and to propose amendments to, the RTS regarding principal adverse impact indicators and transparency of Financial Products.[13] The deadline for this is 11 April 2023.

Under Article 18 SFDR, the ESAs are required to "*take stock of the extent of voluntary disclosures*" in accordance with Article 4(1)(a) and Article 7 (1)(a) and that "[*b*]*y 10 September 2022, and every year thereafter, the ESAs shall submit a report to the EU Commission on best practices and make recommendations towards voluntary reporting standards*." Article 18 also states: "*That annual report shall consider the implications of due diligence practices on disclosures under this Regulation and shall provide guidance on this matter.*" In the light of this requirement, the

---

[7] Regulation (EU) 2019/2088.

[8] Regulation (EU) 2020/852.

[9] See our OnPoint on the EU Commission's adoption of the RTS in April 2022, available here.

[10] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports, is available here.

[11] For more information on the publication of the RTS in the Official Journal, please see our OnPoint, available here.

[12] As referred to in Article 4(1)(a) of SFDR or as required by Article 4(3) and (4) of SFDR.

[13] Details of the ESAs' mandate and the letter from the EU Commission are available here.

ESA published a report (dated 28 July 2022) on the extent of voluntary disclosure of PAI under SFDR.[14] The ESAs surveyed National Competent Authorities (**NCA**s), and used this information to develop a *"preliminary, indicative and non-exhaustive overview of good examples of best practices, and less good examples of voluntary disclosures*." The report also includes a set of recommendations for NCAs to ensure appropriate supervision of financial market participants' practices, such as running regular surveys in their own market to determine whether supervisory entities comply with Article 4 SFDR disclosures.

The Taxonomy Regulation focuses on the 'E' of ESG, with an investment being sustainable if it meets one of six specified environmental objectives set out in Article 9 of the Taxonomy Regulation, does not significantly harm any of the remaining objectives, and is carried out in compliance with the minimum safeguards and technical screening criteria (**TSC**) set out in delegated acts.

The Taxonomy Regulation, which took effect on 1 January 2022, establishes an EU-wide classification system or 'framework' intended to provide businesses and investors with a common language to identify to what degree economic activities can be considered environmentally sustainable. Its disclosure obligations supplement the SFDR rules by requiring that from 1 January 2022 certain additional disclosures must be made for Article 8 and Article 9 Financial Products regarding how their investment activities align with specified criteria and standards. For Financial Products that do not fall into either the Article 8 or Article 9 category, prescribed language must be included that the product does not make Taxonomy-aligned investments. The Taxonomy Regulation has been supplemented by delegated legislation that adds detail to the primary legislation. The EU Taxonomy Climate Delegated Act (Commission Delegated Regulation (EU) 2021/2139),[15] published in the OJ on 21 December 2021, contains the first two sets of TSC for determining which economic activities can qualify as contributing substantially to climate change mitigation or climate change adaptation, and for determining whether that economic activity causes "no significant harm" to any of the other environmental objectives set out in Article 9. It has applied since 1 January 2022.

The EU Taxonomy Article 8 Delegated Regulation (Commission Delegated Regulation (EU) 2021/2178),[16] published in the OJ on 10 December 2021, specifies the content and presentation of information to be disclosed by non-financial undertakings, asset managers, credit institutions, investment firms, and insurance and reinsurance undertakings as well as common rules relating to key performance indicators. It entered into force on 30 December 2021 and has applied since 1 January 2022 with a phased application.

On 9 March 2022, the EU Commission formally adopted a Complementary Climate Delegated Regulation covering nuclear and fossil gas activities, incorporating these into the 'transitional' category of activities under Article 10(2) of the Taxonomy Regulation, and providing associated TSC. The conditions for inclusion of natural gas and nuclear activities include that they contribute to the transition to climate neutrality; for nuclear, that it fulfils nuclear and environmental safety requirements; and for natural gas, that it contributes to the transition from coal to renewables. The Complementary Climate Delegated Regulation also amends the EU Taxonomy Article 8 Delegated Regulation, requiring large listed non-financial and financial companies to disclose the proportion of their activities linked to natural gas and nuclear energy. On 15 July 2022, the Complementary Climate Delegated Regulation was published in the OJ[17] and its provisions will apply from 1 January 2023.

On 6 May 2022, the ESAs announced that they had received a letter[18] (dated 8 April 2022) from the EU Commission mandating them to propose amendments to the RTS in relation to the exposure of Financial Products to investments in fossil gas and nuclear energy activities for full transparency of investments in fossil gas and nuclear energy activities. The ESAs are due to propose amendments by 30 September 2022.

[14] The ESAs' report is available here.

[15] The EU Taxonomy Climate Delegated Act is available here.

[16] The EU Taxonomy Article 8 Delegated Regulation is available here.

[17] Commission Delegated Regulation (EU) 2022/1214 Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities is available here.

[18] Details of the mandate and the EU Commission's letter are available here.

The EU Commission was due to publish a report on the application of the Taxonomy Regulation by 13 July 2022 (and then every three years) (under Article 26(1) of the Taxonomy Regulation). The report has not yet been published. The EU Commission is understood to be developing the framework under the Taxonomy Regulation, which includes adopting delegated legislation on water, biodiversity, pollution prevention and circular economy environmental goals, and focusing on transition activities. The EU Commission was due to adopt TSC for the remaining four environmental objectives under the Taxonomy Regulation (water, circular economy, pollution prevention and biodiversity) in the first half of 2022, with the TSC applying from 2023. At the time of writing neither the framework nor the remaining TSC have been published.

Other EU Commission initiatives will extend the EU Taxonomy Regulation to cover a wider range of environmental factors. There is no clear timeline as to when the Taxonomy Regulation may be extended to cover social issues.

Additional ESG-related regulatory developments include the EU Commission amending MiFID II (product governance/organisational requirements), the UCITS Directive and the AIFMD. These amendments were published in the OJ on 2 August 2021 and entered into force on 22 August 2021 (that is, 20 days after publication in the OJ). The amendments to the AIFMD[19] and UCITS Directive[20] have applied since 1 August 2022, the MiFID II organisational requirements[21] since 2 August 2022, and the MiFID II product governance requirements[22] will apply from 22 November 2022.

In addition, following consultation on changes to the Non-Financial Reporting Directive (**NFRD**), on 21 April 2021, the EU Commission announced proposals for a new Corporate Sustainability Reporting Directive (**CSRD**), amending the NFRD's reporting requirements to ensure consistency between the Taxonomy Regulation and company sustainability reporting. The CSRD revises and strengthens rules introduced by the NFRD, significantly expanding the scope of EU listed and established entities that are in scope of the reporting obligations. CSRD will apply to all large EU companies (where they satisfy certain 'qualifying' criteria), all companies listed on EU regulated markets, small and medium-sized undertakings whose transferable securities are admitted to trading on a trading venue of any Member State, and small and medium-sized undertakings carrying out high-risk economic activities. This is likely to catch a higher number of financial institutions compared to the NFRD, but has also been criticised by some trade associations as not being wide enough.

On 29 June 2022, the final compromise text of the CSRD was published in the Council register[23] and on 14 July 2022 the European Parliament's legal affairs committee approved the text. The European Parliament is expected to formally adopt the CSRD at first reading at the plenary session that is due to take place on 17 October 2022. The Council will then formally adopt the CSRD, and it will be published in the OJ. It will enter into force 20 days after publication and its provisions will have to be integrated into Member States' national laws after 18 months. As currently drafted, application of the CSRD will take place in three stages: (i) 1 January 2024 for companies already subject to NFRD; (ii) 1 January 2025 for large companies that are not presently subject to the NFRD; and (iii) 1 January 2026 for listed SMEs, small and non-complex credit institutions and captive insurance undertakings.

[19] Commission Delegated Regulation (EU) 2021/1255 amending Delegated Regulation (EU) 231/2013 as regards the sustainability risks and sustainability factors to be taken into account by alternative investment fund managers.

[20] Commission Delegated Directive (EU) 2021/1270 amending Directive 2010/43/EU as regards the sustainability risks and sustainability factors to be taken into account for UCITS.

[21] Commission Delegated Regulation (EU) 2021/1253 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain MiFID II organisational requirements and operating conditions for investment firms.

[22] Commission Delegated Directive (EU) 2021/1269 amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors into the MiFID II product governance obligations.

[23] The CSRD compromise text is available here.

Additional developments include the EU Ecolabel framework for certain financial products and Green Bond Standards, proposals for a European Climate Law to write the EU's climate neutrality target into binding legislation and local developments such as the AMF's ESG-related Doctrine.[24]

The EU has also enacted the Low Carbon Benchmark Regulation, which came into force in December 2019. This amended the EU Benchmarks Regulation by introducing two new types of 'climate benchmark' that seek to ensure the integrity of low-carbon benchmarks.

On 23 February 2022, the EU Commission adopted a proposal for a Directive on corporate sustainability due diligence.[25] The impact on companies meeting the required thresholds based in the EU and doing business in the EU is significant as they will now have to ensure human rights and environmental due diligence is engrained in their core business activities. For more information on the global impact of the Directive, see Dechert's OnPoint, available here.

More generally, on 11 February 2022, ESMA published its sustainable finance roadmap for 2022-24 (dated 10 February 2022), which identifies three priorities for its sustainable finance work: tackling greenwashing and promoting transparency; building NCAs' and ESMA's capacities in the sustainable finance field; and monitoring, assessing and analysing ESG markets and risks. These priorities are likely to drive the ESG agenda in Europe.

As part of the proposals set out in the roadmap, on 31 May 2022, ESMA published a Supervisory Briefing[26] to provide NCAs with guidance on integration of sustainability risks and disclosures. In particular to ensure convergence across the EU in the supervision of investment funds with sustainability features, and in combating greenwashing by investment funds.

The UK's post-Brexit ESG agenda

Neither the SFDR nor the Taxonomy Regulation were 'on-shored' in the UK following the end of the Brexit transition period on 31 December 2020. It is now clear that the UK will diverge from the EU, although the UK government has stated that "*at the very least, we will match the ambition of the EU Sustainable Finance Action Plan*."

The UK's legislative proposals have initially focused on the recommendations of the Task Force for Climate-related Financial Disclosures (**TCFD**) that aims to price climate-related risks and opportunities into financial decision-making. The TCFD recommendations have been developed for use globally, and the UK was one of the first countries to endorse the TCFD recommendations, with the UK's 2019 Green Finance Strategy proposing that all UK listed issuers and large asset owners would be disclosing in accordance with TCFD by 2022.

On 9 November 2020, HM Treasury published an Interim Report of the UK's Joint Government-Regulator TCFD Taskforce (the **Report**) and a Roadmap (the **Roadmap**) outlining the UK's plans, which were described as *"charting a path towards mandatory TCFD-aligned climate-related disclosures to help accelerate progress*" over the next five years. The Report also sets out the implementation approach for asset managers (see our OnPoint "Is Brexit Green? A UK Roadmap Towards Mandatory Post-Brexit Climate-Related Disclosures"). Linked to this, in June 2021, the FCA published two consultation papers on climate-related disclosure rules for listed companies and proposals for asset managers, life insurers and FCA-regulated pension providers[27] (CP21/18 and CP 21/17 respectively). For more information, see our OnPoint "FCA Consultation on Enhancing Climate-Related Disclosures by UK Asset Managers."

In December 2021, the FCA published its Policy Statement "Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers"[28] (**PS 21/24**) following from its earlier consultation paper (**CP21/17**). PS 21/24 sets out new rules that apply to in-scope UK asset managers with assets under

[24] For our latest update on the AMF Doctrine, please see our OnPoint "AMF ESG Doctrine: Goldplating SFDR by another name?"

[25] The directive is available here.

[26] ESMA's Supervisory Briefing is available here.

[27] The FCA consultation papers.

[28] PS 21/14 is available here.

management (**AUM**) of £50 billion or more from January 2022 and one year later for smaller firms above the £5 billion exemption threshold, with new firm and product-level disclosure requirements applying from 30 June 2023. PS 21/24 also contains the FCA's final rules and guidance in a new Environmental, Social and Governance (**ESG**) Sourcebook that will be expanded to cover additional sustainability topics over time. For more information, see our OnPoint "FCA Policy Statement on enhancing climate-related disclosures by UK asset managers."

In November 2021, the FCA issued a discussion paper on sustainability disclosure requirements (**SDR**) and investment labels (**DP 21/4**).[29] The FCA envisages entity and product-level disclosures by asset managers and asset owners in respect of investment products in relation to governance, strategy, risk management, metrics and targets. DP21/4 specifically looks at the extent to which the FCA can remain consistent with the disclosure requirements under SFDR while reflecting the needs of the UK market. With regards to investment labels, the FCA considers that classifying and labelling investment products according to objective criteria, and using common terminology, could help combat potential greenwashing and enhance trust. It notes that classification and labelling of sustainable finance products have become increasingly common internationally, albeit with differences in terms of policy aims and practical implementation. The FCA stated in DP21/4 that it intended to consult in Q2 2022 on proposed rules to implement SDR disclosure requirements and sustainable investment labels, but this has been pushed back to Q3 2022. We expect final rules to be in force in Q3/Q4 2023.

Further details of UK developments (such as the 'Dear Chair' letter[30] published on 19 July 2021 addressed to the chairs of authorised fund managers (**AFMs**) containing guiding principles on design, delivery and disclosure of ESG and sustainable investment funds, and the FCA, the Bank of England (the **BoE**) and the Prudential Regulation Authority (**PRA**) actions in the area of diversity and inclusion) are discussed in the Summer 2022 edition of the Horizon Scanner.

See also section 5 – U.S. Regulatory Initiatives for information on the U.S. Securities and Exchange Commission (**SEC**) proposals for climate related disclosures.

Further information is available on our dedicated Dechert ESG for Asset Managers site.

2. LIBOR

31 December 2021 marked the date after which the majority of LIBOR tenors no longer exist.

Since 1 January 2022, only five tenors of USD LIBOR continue to be published in their pre-2022 form, and their publication is scheduled to cease at the end of June 2023. As a result, in 2022 there has been increased focus on the alternative largely risk-free rates (**RFRs**) that are the established replacements for each of the LIBOR family of currencies: SONIA (GBP), SOFR (USD), SARON (CHF), €STR (EURO) and TONA (JPY). Given June 2023 is now less than one year away, focus is increasingly (and currently almost solely) on USD LIBOR and SOFR.

Set out below are key developments with respect to the UK, U.S. and EU. Previous editions of the Horizon Scanner have covered developments relating to LIBOR, the transition to the RFRs and global benchmark reform in significant detail. We have a range of LIBOR resources available. Our Summer 2022 LIBOR update webinar, "One Year Out: Are You Ready?" is available here, and our LIBORcast podcast series, including discussions with key players such as ISDA, the FCA and Fitch Ratings, can be found here.

UK Developments

The Financial Services Act 2021 (**FS Act**) gave the FCA new and enhanced powers to manage the wind down of a critical benchmark (such as LIBOR). The FCA has already exercised its power to retain LIBOR on a changed methodology for certain GBP LIBOR and JPY LIBOR settings that have been deemed unrepresentative. That new rate (i.e., LIBOR in name, but calculated on a changed methodology) is so-called 'synthetic LIBOR.'

[29] DP 21/4 is available here.

[30] The 'Dear Chair' letter is available here.

Six 'synthetic' GBP and JPY LIBOR settings are available for the duration of 2022- with the FCA confirming that synthetic JPY LIBOR will cease at the end of 2022, and availability of synthetic GBP LIBOR is not guaranteed beyond end-2022. Whilst five USD LIBOR settings are available until mid-2023, the messaging from regulators remains that there should be no new use of USD LIBOR and the FCA, exercising powers given to it under the FS Act, has restricted UK supervised entities from using USD LIBOR except in very limited cases. There has been no decision as to whether any synthetic version of USD LIBOR will be available after June 2023.On 30 June 2022, the FCA published a consultation paper (**CP22/11**)[31] (i) requesting feedback on the retirement of synthetic GBP LIBOR; and (ii) seeking information on USD LIBOR, namely if there are any insurmountable barriers (legal, operational or other) to the smooth transition to risk-free rates for non-U.S. governed contracts that reference USD LIBOR. The consultation also requests feedback on the consequences for market participants if the FCA were to compel IBA to produce a synthetic USD LIBOR after 30 June 2023. The FCA emphasises that it has not made any decision on whether it would be appropriate or desirable to produce a synthetic USD LIBOR but is seeking information to help inform its assessment which will be made in due course. The consultation closed to responses on 24 August 2022.

Later in 2022, based on responses to the consultation, the FCA will review its decisions to compel continued publication of the one-month, three-month and six-month GBP LIBOR settings and notify the market of the outcome. No specific timing has been provided.

For market participants with LIBOR-linked bonds, on 16 August 2022, the FCA issued a statement[32] relating to the transition of outstanding LIBOR bonds. In the statement, the FCA strongly encourages issuers of the remaining LIBOR-linked bonds issued under English or other non-U.S. laws that make consent solicitation practicable, to schedule consent solicitation processes for conversion to fair alternative rates. The statement also includes some general information on sterling and yen LIBOR and speaks to any possibility for synthetic USD LIBOR.

Most recently, on 30 August 2022, ICE Benchmark Administration Limited (**IBA**), the benchmark administrator for both ICE Swap Rate and LIBOR, announced that it was consulting[33] on the potential cessation of all USD LIBOR ICE Swap Rates after 30 June 2022.

IBA does not expect to be able to continue to publish USD LIBOR ICE Swap rate settings for which the USD LIBOR settings serve as the underlying rate for the floating leg of the relevant swap transaction after 30 June 2023, because it does not expect sufficient (or perhaps any) input data to be available. IBA is consulting on its intention to cease publication of USD LIBOR ICE Swap Rate for all tenors immediately after publication on 30 June 2023. The consultation closes on 7 October 2022.

U.S. Developments

Less than a year remains until the final (and the most widely used) USD LIBOR tenors end. The focus in the U.S. is on transition and the detail of the replacement rates, principally SOFR across different markets.

The U.S. 'statutory solution' is in the form of U.S. Federal legislation and New York and Alabama state legislation. The New York and Alabama state LIBOR legislation took effect for contracts referencing one-week and two-month USD LIBOR from and after 2 January 2022. At the federal level, on 15 March 2022, the Consolidated Appropriations Act, 2022[34] (that includes the framework for the Adjustable Interest Rate (LIBOR) Act, the **LIBOR Act**) came into effect. The Consolidated Appropriations Act, 2022 provides a solution for legacy financial contracts tied to LIBOR and creates safe harbours for the transition from LIBOR to SOFR.

This new federal LIBOR law takes a similar approach to the legislation that was initially proposed by the Alternative Reference Rates Committee (**ARRC**) in 2020 and applies to so called U.S. law governed "covered contracts". Those are contracts that reference overnight and one-, three-, six- and 12-month tenors of U.S. dollar LIBOR and

[31] CP22/11 is available here.

[32] The FCA statement is available here.

[33] IBA's consultation on the cessation of USD LIBOR ICE Swap Rates is available here.

[34] The Consolidated Appropriations Act, 2022 is available here.

either do not have fallbacks or do have fallbacks which do not identify a determining person and are based on LIBOR or require a person to conduct a poll or similar enquiry for information, or the relevant determining person does not determine a replacement benchmark in the timeframe prescribed. The LIBOR Act does not extend to any LIBOR other than U.S. dollar LIBOR.

The LIBOR Act required that the Board of Governors of the Federal Reserve (the Federal Reserve Board) promulgate rules to implement the LIBOR Act not later than 180 days after enactment. On 19 July 2022, the Federal Reserve Board released this highly anticipated proposed rulemaking.[35] The proposal will result in references to LIBOR in covered contracts being replaced with references to the applicable Board-selected replacement rate after 30 June 2023. The proposed rulemaking was published in the Federal Register[36] and closed to comments on 29 August 2022.

Consistent with the UK and EU, the CFTC has also been making changes to update the derivatives clearing obligation to reflect the cessation of certain LIBORs and the inclusion of RFRs. The Commodity Futures Trading Commission's (**CFTC**) final rule, Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps To Account for the Transition From LIBOR and Other IBORs to Alternative Reference Rates (the **Rule**),[37] has been published in the Federal Register, with a first effective date of 23 September 2022.

The Rule makes amendments to update the set of interest rate swaps that must be cleared under the Commodity Exchange Act (**CEA**), and the CFTC's regulations via a derivatives clearing organisation (**DCO**) that is registered under the CEA (**registered DCO**) or a DCO that has been exempted from registration under the CEA (**exempt DCO**) to reflect the shift from swaps that reference IBORs to swaps that reference RFRs.

The updated dates for the Rule and amendments are:

- Effective 23 September 2022:
    - Removes the requirement to clear swaps referencing GBP LIBOR, CHF LIBOR, JPY LIBOR and the Euro Overnight Index Average (**EONIA**) in each of the fixed-to-floating swap, basis swap, forward rate agreement (**FRA**) and overnight index swap (**OIS**) classes, as applicable;
    - Adds a requirement to clear OIS referencing CHF Swiss Average Rate Overnight (with a stated termination date range of seven days to 30 years), the JPY Tokyo Overnight Average Rate (seven days to 30 years) and the Euro Short-Term Rate (seven days to three years); and
    - Extends the stated termination date range for GBP Sterling Overnight Index Average OIS required to be cleared to include seven days to 50 years.
- Effective 31 October 2022:
    - Adds a requirement to clear OIS referencing USD SOFR (seven days to 50 years) and the Singapore Overnight Rate Average (seven days to 10 years).
- Effective 1 July 2023:
    - Removes the requirement to clear interest rate swaps referencing USD LIBOR and the Singapore Dollar Swap Offer Rate in each of the fixed-to-floating swap, basis swap and FRA classes, as applicable.

EU Developments

In Europe, EONIA and all tenors of euro LIBOR ceased to be published from the start of 2022. EURIBOR continues to be published using the hybrid methodology introduced in 2019.

---

[35] The proposed rulemaking is available here.
[36] The Register entry is available here.
[37] The Rule is available here.

The EU 'statutory solution' takes the form of an amending Regulation[38] to the existing EU Benchmarks Regulation, creating a framework for enabling the statutory designation of a replacement benchmark to ensure a smooth transition when important benchmarks are no longer in use and to protect the stability of the EU financial markets.

Under the amending Regulation, the EU Commission will designate a replacement rate only in contracts and financial instruments that (i) do not contain any fallback provisions, or (ii) do not contain "suitable" fallback provisions (the so-called "tough legacy" contracts). The amending Regulation applies to EU law-governed contracts and MiFID II financial instruments that reference an affected benchmark and to non-EU law-governed contracts that reference an affected benchmark, where the contracting parties are EU entities, and the applicable jurisdiction does not provide for the orderly wind-down of the benchmark in question. The amending Regulation also extends the third-country transitional period until the end of 2023, with an option for a further two-year extension, which means EU-supervised entities can continue to use third-country benchmarks until that time.

The EU Commission has nominated replacement rates for CHF LIBOR and EONIA, meaning in-scope contracts were updated to SARON and €STR, each with a spread adjustment applied from 1 January 2022. The EU Commission announced in December 2021 that it will be issuing implementing acts for GBP LIBOR[39] and JPY LIBOR[40] contracts in Q1 2022. At the time of writing, these implementing acts have not been issued. If such changes do take effect, the designated replacement rates will replace contractual references to certain GBP and JPY LIBOR rates in the EU.

3. EUROPEAN REGULATORY INITIATIVES

3.1 AIFMD marketing/pre-marketing – cross-border distribution of investment funds

Changes to EU law on the cross-border distribution of AIFs and UCITS came into effect on 2 August 2021. Following Brexit, UK AIFMs are out of scope for the majority of these new rules as they apply to EU AIFMs marketing EU AIFs. Some jurisdictions have introduced 'gold plating' measures, however, extending the new pre-marketing rules to apply to non-EU AIFMs as well as EU AIFMs.

The changes were made by Regulation (EU) 2019/1156 and Directive (EU) 2019/1160 and are commonly referred to as the CBDF framework – which forms part of the EU's capital markets union initiative. (See Section 3.3 below).

ESMA guidelines[41] for funds' marketing communications under Article 4 of the Regulation were published on 2 August 2021 and have applied since 2 February 2022. They specify the requirements for marketing communications promoting UCITS and AIFs (including EuSEFs, EuVECAs and ELTIFs). Since 2 August 2021, marketing materials for AIFs and UCITS are formally required to be identifiable as such and to describe the potential risks and rewards of purchasing units or shares in UCITS/AIFs in an equally prominent manner. All information included in marketing communications must be fair, clear and not misleading, in line with equivalent MIFID requirements.

The EU Commission was due to report on reverse solicitation under the CBDF framework by 2 August 2021, but at the time of writing has not done so.

For more information, see the Summer 2022 edition of the Horizon Scanner.

3.2 Further AIFMD developments

EU Commission review of AIFMD: Following the EU Commission's wide-ranging consultation on AIFMD in October 2020, it published its proposals on 25 November 2021 (the **Proposals**).

[38] EU Regulation 2021/168 amending Regulation (EU) 2016/1011 as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements for certain benchmarks in cessation, and amending Regulation (EU) No 648/2012, published in the OJ on 10 February 2021.

[39] The draft GBP LIBOR implementing acting act is available here.

[40] The draft JPY LIBOR implementing acting act is available here.

[41] The English language version of the ESMA Guidelines is available here.

The Proposals cover delegation, marketing AIFs under the National Private Placement Regime, liquidity risk management, loan funds, depositaries, data reporting and fees and charges. The EU Commission is proposing similar changes to the UCITS Directive on delegation, liquidity risk management, data reporting for market monitoring purposes and regulatory treatment of custodians. We discuss the Proposals in detail in our OnPoint "AIFMD – the EU Commission publishes its proposals for reform of the AIFMD."

The Council adopted its general approach on 17 June 2022.[42] The European Parliament Rapporteur on this file published her draft report on 16 May 2022,[43] and on 4 July 2022 the European Parliament published the balance of the Rapporteur's draft report comprising an additional 443 proposed amendments from other MEPs.[44] The European Parliament's report will be voted on towards the end of October. Trilogue discussions between the EU Commission, EU Parliament and Council are expected to commence in Q4 2022. The current expectation is that agreement will be reached by early/mid 2023, with publication of the final directive in the OJ in mid 2023. Member States will have 24 months to implement the changes. This means the amended AIFMD is likely to apply from early 2025.

ESG: Delegated legislation integrating sustainability into AIFMD (and the UCITS Directive) have applied since 1 August 2022 (see Section 1 ESG above for details).

Questions and Answers: On 20 July 2022, ESMA published an updated version of its Q&A on AIFMD to include:

- A new question 4 regarding responsibility to ensure compliance with the rules governing marketing communications;
- A new question 15 relating to reconciliation frequency for an AIF or UCITS trading on a daily basis; and
- A new question 16 relating to Reconciliations with tri-party collateral managers.

ESMA last updated the Q&As on AIFMD on 20 May 2022.

3.3 Capital Markets Union action plan

On 25 November 2021, the EU Commission adopted a package of measures aimed to deliver on several key commitments in the 2020 Capital Markets Union (**CMU**) action plan. The package includes four legislative proposals relating to (i) the European Single Access Point (**ESAP**), (ii) review of the European Long-Term Investment Funds Regulation (**ELTIF**) (see 3.5 ELTIF Reform below for more details), (iii) review of the AIFMD (and, to the relevant extent, the UCITS Directive (see 3.2 Further AIFMD developments above for details)) and (iv) review of the MiFIR. The EU Commission's ongoing work in 2022 includes publishing a report on the functioning of the EU securitisation framework, assessing the feasibility of a pan-EU label for financial advisors and publishing a report on further harmonisation of EU rules and supervisory convergence.

3.4 CSDR

The settlement discipline regime (**SDR**) requirements under the European Central Securities Depositories Regulation (**CSDR**) took effect on 1 February 2022.[45]

The SDR aims to discourage settlement failures at central security depositories (**CSDs**) operating securities settlement systems across the EU, such as Euroclear and Clearstream. The CSDR SDR is agnostic as to the location of the counterparties to a trade, so long as the trade settles at a relevant CSD and relates to an in-scope instrument. The SDR has two main elements: measures to prevent settlement fails (Article 6 of CSDR), and measures to address settlement fails (Article 7 of CSDR). The SDR measures to address settlement fails comprise

[42] The Council position is available here.
[43] The draft European Parliament's report is available here.
[44] The additional amendments are available here and here.
[45] The UK government announced in June 2020 that it would not be implementing the settlement discipline regime pursuant to UK CSDR following Brexit, meaning that UK securities settlement systems are not subject to a new SDR.

reporting requirements, including rules for trade allocation and confirmation processing; cash penalties for transactions that do not settle or that are not matched; and the mandatory buy-in (**MBI**) requirements.

After widespread calls for delay, the MBI regime has now, in effect, been delayed for at least three years.

This delay is a result of the EU Commission's adoption on 6 July 2022, of a draft Delegated Regulation amending the RTS on Settlement Discipline[46] to suspend the application date of the MBI regime under the CSDR. This is intended to give the EU Commission, the European Parliament and Council additional time to determine the best way forward to improve settlement efficiency (principally expected to be via the CSDR Refit process as described below). The draft delegated regulation amending the RTS on Settlement Discipline is currently subject to scrutiny by the European Parliament and Council. In the meantime, ESMA's December 2021 "de-prioritisation" letter, akin to a U.S. "no action letter" will continue to apply.

CSDR REFIT: On 16 March 2022, the EU Commission published a legislative proposal[47] for amending the CSDR as regards settlement discipline, cross-border provision of services, supervisory co-operation, provision of banking-type ancillary services and requirements for third-country central securities depositories (**CSDR REFIT Proposal**).

For MBI, the CSDR REFIT Proposal introduces a 'two-step approach' under which MBI would only apply by way of an EU Commission-delegated act if one of a series of conditions is satisfied, one of which is the failure of the cash penalties regime to improve settlement fails. Other proposals relate to passporting and measures for improving co-operation between supervisory authorities, and for oversight of third-country CSDs. The Council and the European Parliament are considering the legislative proposal. The EU Commission intends the proposed regulation to enter into force on the twentieth day following its publication in the OJ. However, certain provisions will apply 24 months after that date.

On 11 July 2022, ESMA published a consultation paper on amendments to Article 19 of the CSDR RTS on settlement discipline.[48] Article 19 provides for a specific collection and distribution process for cash penalties to be carried out by central counterparties (**CCPs**), so that, for settlement fails relating to cleared transactions where CCPs interpose themselves between counterparties, cash penalties are not applied to CCPs. ESMA is inviting stakeholders to submit their input by 9 September 2022.

Questions and Answers: ESMA published an updated version of its CSDR Q&A[49] on 4 August 2022. Updates have been made to Settlement Discipline Questions 3 in relation to the calculation of cash penalties, and a new Settlement Discipline Question 10 has been added in relation to bilateral cancellation facility. The Q&A on CSDR were previously updated on 20 May 2022.

3.5 ELTIF reform

Following its consultation on the review of the European Long-term Investment Fund (**ELTIF**) Regulation in October 2020, the EU Commission published its proposals for reform of the ELTIF Regulation[50] on 25 November 2021. An EU Commission consultation on the proposals was open for feedback until 21 March 2022. For full details of ELTIF proposals for reform, see the Spring 2022 edition of the Horizon Scanner.

On 24 May 2022, the Council announced that it had agreed on a negotiating mandate for amendments to the ELTIF Regulation.[51]

This reflects three objectives:

[46] Commission Delegated Regulation (EU) 2018/1229 of 25 May 2018 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on settlement discipline.

[47] The CSDR REFIT Proposal is available here.

[48] The consultation is available here.

[49] The CSDR Q&A are available here.

[50] The legislative proposal for amendments to the ELTIF Regulation is available here.

[51] The Council's final compromise text (dated 20 May 2022) is available here.

- Channelling more financing to SMEs and long-term projects, including by removing existing constraints on portfolio composition, especially for those distributed solely to professional investors (for example by removal of the diversification requirements);
- Enhancing the role of retail investors by making ELTIFs more attractive to them and lifting barriers to entry (for example by removal of the EUR 10,000 initial minimum investment requirement and the 10 percent limitation on aggregate investment); and
- Maintaining high investor protection standards and providing retail investors with all relevant information.

The European Parliament announced on 20 June 2022 that it has agreed its negotiating position.[52]

The trilogue discussions are expected to start after the summer. There is overall convergence between the Commission, Council and European Parliament, and there does not appear to be significant areas of disagreement. The expectation is that agreement on this file will be reached quickly. It is possible that there may be agreement on the text of the revised ELTIF Regulation as early as November 2022, with publication in the OJ in December 2022/January 2023.

Although the UK on-shored the ELTIF Regulation, it is not proposing to make amendments to the UK ELTIF, meaning that the two regimes will diverge once the EU ELTIF proposals are adopted.

3.6 EU European Markets and Infrastructure Regulation (EMIR)

There have been no significant developments in relation to EMIR since February 2022. Set out below are some items of note. Please refer to the Spring 2022 edition and the Summer 2022 edition of the Horizon Scanner for full details on matters such as the effects of LIBOR cessation and benchmark reform, regulatory reporting and clearing thresholds.

EMIR REFIT – changes to the EMIR reporting obligation: On 10 June 2022, the EU Commission adopted a series of implementing and delegated regulations setting out implementing technical standards (**ITS**) and RTS supplementing EMIR in relation to reporting, data quality and data registration of trade repositories under EMIR Refit. The publication follows a July 2021 ESMA consultation[53] and Final Report.[54] The implementing and delegated regulations must now progress through the usual legislative process. If the European Parliament and the Council do not object within three months they will take effect 20 days after their publication in the OJ. The key substantive changes to the EMIR reporting requirement will not take effect until 18 months following publication in the OJ.

Clearing and Trading Obligations: On 11 July 2022, ESMA launched a consultation[55] relating to a second set of RTS proposing further changes to the derivatives clearing (**CO**) and trading obligations (**DTO**) in the light of global benchmark reform. Specifically, ESMA's proposals include (i) for the CO (a) the introduction of the overnight indexed swap (**OIS**) class referencing TONA (JPY) and (b) the expansion of the maturities in scope of the CO for the OIS class referencing SOFR (USD); and (ii) for the DTO, the introduction of certain classes of OIS referencing €STR (EUR), which have shown a substantial increase in liquidity over the last months. Comments on the Consultation Paper can be made up to 30 September 2022. To recap, the first set of draft RTS[56] was adopted by the EU Commission on 8 February 2022 and entered into force on 18 May 2022. The first set of RTS removed the EONIA and LIBOR classes, while it introduced OIS classes referencing €STR and SOFR to the CO as well as expanded the maturities in scope for the OIS class referencing SONIA.

On 3 June 2022, ESMA published its final report[57] following a review of the commodity derivative clearing thresholds under EMIR. The EMIR Refit Regulation mandates ESMA to periodically review the EMIR clearing

[52] The European Parliament's ELTIF report is available here.
[53] The July 2021 ESMA Consultation is available here.
[54] The Final Report is available here.
[55] The consultation is available here.
[56] The RTS are available here.
[57] The report "EMIR RTS on the commodity derivative clearing threshold" is available here.

thresholds and update them where necessary to ensure that the thresholds remain appropriate. Following a review, ESMA proposes to increase the clearing threshold for commodity derivatives from EUR3 billion to EUR4 billion. The proposed draft RTS that would amend Delegated Regulation (EU) No 149/2013 to reflect the change in the clearing thresholds is set out in Annex II to the final report. The draft RTS presented in the Annex are being submitted to the EU Commission for endorsement in the form of a Commission Delegated Regulation, (i.e., a legally binding instrument directly applicable in all EU Member States). Following their endorsement, the draft RTS will be subject to non-objection by the European Parliament and the Council.

On 16 June 2022, ESMA published a statement[58] on the implementation of the clearing obligation for pension scheme arrangements (**PSAs**) under EMIR. The current temporary exemption was due to expire on 18 June 2022. The EU Commission adopted a Delegated Regulation[59] on 9 June 2022 to extend the temporary clearing exemption for PSAs until 18 June 2023. ESMA has stated that from 19 June 2022 until the approval process of the Delegated Regulation has been completed, ESMA expects competent authorities (i) not to prioritise their supervisory actions in relation to the clearing obligation for PSAs, and (ii) to generally apply their risk-based supervisory powers in their day-to-day supervision of applicable legislation in this area in a proportionate manner.

Initial margin. Phase 5 of the EMIR regulatory initial margin requirements for entities whose aggregate average aggregate notional amount, so called 'AANA' by reference to March, April and May 2021 exceeded EUR 50bn took effect on 1 September 2021. Phase 6 followed on **1 September 2022** when the relevant AANA threshold for the final phase is EUR 8bn.

Questions and Answers: The most recent ESMA EMIR Q&A remains the 19 November 2021 version, available here.

EMIR in the UK: See Section 4.9 below for updates in relation to UK EMIR, the UK "onshored" version of EMIR.

3.7 MiFID II "quick fix"' and further proposed amendments

For details on MiFID II "quick fix" and the EU Commission's proposed amendments to MiFID and MiFIR regimes (announced on 25 November 2021), see the Summer 2022 edition of the Horizon Scanner.

ESMA Consultation on Suitability Guidelines: On 27 January 2022, EMSA announced a consultation on suitability requirements under MiFID. As noted in Section 1 - ESG, MiFID II Delegated Regulation has been updated to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms (Commission Delegated Regulation (EU) 2021/1253). The purpose of the consultation relates to the 2018 MiFID II Guidelines on MiFID II suitability requirements. The main amendments introduced to the MiFID II Delegated Regulation and reflected in the guidelines are the collection of information from clients on sustainability preferences, assessment of sustainability preference; and organisational requirements. The consultation closed to comment on 27 April 2022. ESMA expects to publish a final report in Q3 2022.

ESMA Consultation on Product Governance Guidelines: On 8 July 2022, ESMA announced it is consulting[60] on reviewed guidelines on MiFID II product governance guidelines. ESMA proposes updating the 2017 product governance guidelines following several recent regulatory and supervisory developments, including the outcome of the 2021 common supervisory action (**CSA**) on product governance.[61] The main proposals in the draft guidelines relate to:

- The specification of any sustainability-related objectives with which a product is compatible;
- The practice of identifying a target market per cluster of products instead of per individual product;

[58] The statement is available here.
[59] The delegated regulation is available here.
[60] The consultation paper is available here.
[61] The report on the CSA is available here.

- The determination of a compatible distribution strategy where a distributor considers that a more complex product can be distributed under non-advised sales; and
- The periodic review of products, including the application of the proportionality principle.

The consultation paper also includes good practices identified in the 2021 CSA to complement the existing guidelines, as well as an additional case study. ESMA believes that these practical examples will help firms comply with the relevant product governance requirements.

The consultation closes on 7 October 2022. ESMA will consider the feedback it receives to the consultation in Q4 2022 and expects to publish a final report in Q1 2023.

Tied Agent Framework under MiFID: On 2 February 2022, ESMA published a supervisory briefing setting out its expectations under the MiFID II framework for firms that use tied agents[62] (the **Briefing**). The Briefing includes specific focus on cases where these agents are legal persons, or are controlled by or have close links to other entities, including third-country entities. For more information, see our Alert "Tied Agents - ESMA Statement on Supervisory Expectations."

Questions and Answers: ESMA published updated Q&As on MiFID and MiFIR transparency issues on 5 September 2022.

On 15 July 2022, ESMA published an updated version of its Q&As on market structures issues under MiFID II and MiFIR. The updated Q&As include the following two new Q&As relating to algorithmic trading. ESMA last updated the Q&As in April 2021.

On 19 July 2022, ESMA published an updated version of its Q&As on MiFIR Data Reporting Q&As.

The UK has also introduced changes to UK MiFID similar to the 'quick fix' Directive, most of which were effective from 26 July 2021 (see Section 4.6 below for details on UK MiFID).

3.8 IFR and IFD

From 26 June 2021, the Investment Firm Regulation ((EU) 2019/2033) (**IFR**) started to apply, and EU Member States were expected to apply legislation and regulation implementing the Investment Firms Directive ((EU) 2019/2034) (**IFD**) from that date.

Previously, investment firms authorised under MiFID II were subject to bank-style prudential requirements in the CRR and the CRD IV Directives. The IFR and the IFD establish a new prudential framework for these firms:

- Certain systemically important firms are reclassified as credit institutions and subject to prudential requirements set out in the Capital Requirements Regulation (**CRR**) and the Capital Requirements Directive IV (**CRD IV**) and are not subject to the IFR and the IFD. If established in Member States participating in the banking union, they will come within the scope of the single supervisory mechanism;
- All other MiFID investment firms are subject to the new IFR and IFD prudential framework. Small and non-interconnected investment firms are subject to limited prudential requirements;
- 'K-factors' are used in the classification of investment firms and in the new capital requirements methodology for investment firms. K-factors are quantitative indicators intended to represent the risks that an investment firm can pose to customers, to market access or liquidity, and to the firm itself; and
- Investment firms are subject to revised remuneration and governance standards, set out in the IFD.

[62] Per Article 4(29) of MiFID II, a tied agent is a natural or legal person who, under the full and unconditional responsibility of only one firm on whose behalf the tied agent acts, "*promotes investment and/or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client in respect of investment services or financial instruments, places financial instruments or provides advice to clients or prospective clients in respect of those financial instruments or services*."

There have been no significant developments to the IFR nor IFD since the Summer 2022 edition of the Horizon Scanner.

The UK was not required to apply new EU legislation after the end of the transition period, and neither the IFR nor IFD were on-shored. However, on 1 January 2022, the UK introduced a prudential regime for FCA-authorised investment firms, the Investment Firms Prudential Regime (**IFPR**), that is similar to the IFR/IFD (see Section 4.5 below).

3.9 EU Short Selling Regulation

There have been no significant developments to Short Selling Regulation ((EU) 236/2012) (**SSR**) since the Summer 2022 edition of the Horizon Scanner.

See Section 4.11 below for updates in relation to the UK Short Selling Regulation or UK SSR.

3.10 EU Commission review of AML regime

The EU Commission adopted a package of legislative proposals on 20 July 2021 to strengthen and modernise the European Anti-Money Laundering and Countering the Financing of Terrorism (**AML/CTF**) laws. The proposals include a new EU AML and CTF single rulebook with rules that are directly applicable across the EU, and a new EU-level AML and CTF authority (**AMLA**) co-ordinating all national AML and CTF supervisors.

The European Parliament and Council are considering the EU Commission's proposals, with the EU Commission aiming to adopt legislative proposals in 2022 and bring the new regime into force in 2025. Certain provisions of the AMLA Regulation are expected to apply from 1 January 2023, to enable the AMLA to be established. For further details, see the Summer 2022 edition of the Horizon Scanner.

On 7 June 2022, the Council published a report[63] detailing its progress of the package of AML/CFT proposals noting the following:

- The French Presidency[64] has focused its efforts on the regulation establishing the AMLA (**AMLA Regulation**);[65]
- On the AML Regulation (**AMLR**),[66] the French Presidency has sought to lay the foundations for a coherent and effective discussion on the substance of the regulation, which will continue under the Czech Presidency.[67] Particular attention has been paid to the fundamental elements of the AMLR, namely the harmonisation of the definitions and the precise definition of the scope of the entities covered; and
- On AMLD6,[68] the French Presidency has focused its efforts on issues relating to cooperation and coordination between EU supervisory authorities, the sanctions and corrective measures they can apply, joint analyses and exchanges of information between financial intelligence units and with other authorities, and financial intelligence units' powers to impose suspensions. These discussions will continue under the Czech Presidency.

[63] The Report is available here.
[64] The French Presidency of the EU Council ran from 1 January 2022 through 30 June 2022.
[65] Proposed Regulation establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism and amending Regulations (EU) No 1093/2010, (EU) 1094/2010, (EU) 1095/2010.
[66] Proposed Regulation on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.
[67] The Czech Presidency is from 1 July 2022 through 31 December 2022.
[68] Proposed Directive on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849.

In terms of recent developments, on 29 June 2022, the European Parliament and Council reached a provisional political agreement on the proposed recast revised WTR.[69] The accompanying press release[70] focused on the extension of the rules on information accompanying the transfers of funds to encompass transfers of cryptoassets. The introduction of this 'travel rule' will "*ensure financial transparency on exchanges in cryptoassets and will provide the EU with a solid and proportional framework that complies with the most demanding international standards on the exchange of cryptoassets," with the Council making specific reference to recommendations 15 and 16*[71] *of the Financial Action Task Force (**FATF**), the global money laundering and terrorist financing watchdog."* The aim of the recast revised WTR is to introduce an obligation for cryptoasset service providers to collect and make accessible certain information about the originator and the beneficiary of the transfers of cryptoassets they operate. This is what payment service providers currently do for wire transfers. The Council says "*this will ensure traceability of cryptoasset transfers in order to be able to better identify possible suspicious transactions and block them.*"

The recast revised WTR also requires that the full set of originator information travel with the cryptoasset transfer, regardless of the amount of cryptoassets being transacted. There will be specific requirements for cryptoasset transfers between cryptoasset service providers and un-hosted wallets. Co-legislators also agreed on the need to ensure traceability of cryptoasset transfers and aligned the timetable for application of this regulation with that of the markets in cryptoassets (**MiCA**) regulation (see 3.15. below). The next step is for the Council and the Parliament to confirm their approval of the provisional agreement reached in June before the proposal can be formally adopted.

With regard to the AMLA Regulation, the Council published a note[72] setting out its partially-agreed mandate for negotiations with the Parliament, together with a further 'I' item note[73] adding further information as to the state of play of this file. The mandate is not fully agreed as the location of the seat on the AMLA (Regulation 4) remains subject to discussion.

The European Parliament and Council are considering the EU Commission's proposals, with the EU Commission aiming to adopt legislative proposals in 2022 and bring the new regime into force in 2025. Parts of the AMLA Regulation are expected to apply from 1 January 2023, to enable the AMLA to be established.

3.11 EU Benchmarks Regulation

See Section 2 – LIBOR (above) for more detail on recent developments relating to LIBOR's cessation and benchmark reform.

On 24 March 2021, ESMA published an updated statement[74] (dated 9 March 2021) on the application of key provisions in the Benchmarks Regulation (**EU BMR**) in the light of Brexit, specifying the EU's approach to UK-based third-country benchmarks, as well as UK-endorsed and recognised benchmarks.

Following the end of the Brexit transition period, UK-based administrators were removed from the ESMA register of administrators as they were no longer EU administrators. Since then, UK administrators have qualified as third-country administrators. The EU BMR includes a transitional period until 31 December 2023. During this period, EU27 supervised entities can still use benchmarks provided by third-country administrators, including UK ones, provided the benchmark is already used as a reference for financial instruments, financial contracts or for measuring the performance of an investment fund.

[69] Proposed Directive on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849.

[70] The Council press release is available here.

[71] Recommendation 15 sets the global AML/CFT Standards for virtual assets (**VA**) and virtual assets service providers (**VASP**s), and Recommendation 16 requires VASPs to obtain, hold and transmit required originator and beneficiary information, immediately and securely, when conducting VA transfers.

[72] The Note is available here.

[73] The "I" Item Note is available here.

[74] The statement can be viewed here.

The EU BMR transitional period also applies to UK-recognised or endorsed third-country benchmarks that were included in the ESMA register before the end of the Brexit transition period following a recognition or an endorsement status granted by the UK.

In the absence of the EU Commission granting equivalence (considered unlikely), UK-based benchmark administrators have until 31 December 2023, to apply for recognition or endorsement in the EU, which would enable their benchmarks to be once again included in the ESMA register. It is expected that this equivalence will be extended to 2025.

There have been two recent consultations on the EU BMR. The first, issued by the European Commission in May 2022 sought views on potential improvements to the EU BMR as regards the rules applicable to third-country benchmarks and the impact of the third-country regime taking effect from 1 January 2024. Comments were due by 12 August 2022. The outcome of the consultation is expected to result in a Q4 2022 proposal to review the rules for third-country benchmarks.

Then, on 8 July 2022, ESMA published a consultation paper[75] on amendments to Commission Delegated Regulation (EU) 2018/1645 supplementing the EU BMR with regard to RTS for the form and content of an application for recognition. The review of the RTS also aims to ensure that the application for recognition includes all relevant information to enable ESMA to assess whether the applicant has established the necessary arrangements to fulfil the EU BMR's requirements. The deadline for responses to the proposals was 9 September 2022. ESMA expects to publish a final report and submit draft technical standards to the EU Commission in Q4 2022.

Questions and Answers: On 23 June 2022, ESMA updated the EU BMR Q&As. ESMA last published an update to the Q&As on 1 April 2022.

3.12 EU SFTR

The Securities Financing and Transaction Regulation (**SFTR**) reporting requirements went live in July 2020 and commenced in October 2020 for financial counterparties, including UCITS, AIFs and in-scope third-country entities not caught by the first phase in July 2020. ESMA guidelines on the calculation of positions by trade repositories under the SFTR started to apply from 31 January 2022. The guidelines are intended to make sure that uniform methodology is used under both EMIR and SFTR, bearing in mind specific requirements for Securities Financing Transactions (**SFT**) reporting.

On 12 July 2022, ESMA issued its third statement on the implementation of LEI requirements for third-country issuers under SFTR, further extending the current forbearance period.[76] Based on an analysis of SFTR reports, ESMA concluded that the gap in the coverage of issuer LEIs outside Europe is still significant, with around 20 percent of non-EEA securities lacking the code. ESMA therefore decided to extend the forbearance period until further notice, while continuing closely to monitor the situation. If ESMA decides in the future to make the reporting of non-EEA issuer LEIs mandatory, it will give the market at least six-months' advance notice.

The UK has not issued an equivalent statement, although it is hoped that the FCA will consider adopting a similar approach to ESMA.

SFTR Refit: ESMA has indicated that the anticipated broader review of SFTR is not expected to be launched later in 2022, as was previously expected. This was confirmed in a letter[77] from ESMA to the EU Commission dated 28 June 2022, regarding the prioritisation of ESMA's 2022 deliverables.

[75] The Consultation is available here.

[76] The ESMA statement is available here.

[77] The letter from ESMA to the EU Commission is available here.

Questions and Answers: On 19 July 2022, ESMA published an updated version of its Q&As on complying with reporting requirements under SFTR. ESMA has added new Q&As on (i) the construction of a trade state report and (ii) reporting of valuation and collateral on the last day of a securities financing transaction.

ESMA last updated the Q&As in March 2022.

The UK and SFTR: See Section 4.13 for updates with respect to the UK "on-shored" version of SFTR, "UK SFTR".

3.13 EU PRIIPs Regulation

2021 and the beginning of 2022 saw several consultations and developments with regard to PRIIPs, which are covered in detail in the September 2021, Spring 2022 and the Summer 2022 editions of the Horizon Scanner.

To recap, in December 2021, the EU Commission published the following legislation:

- A delegated regulation (Commission Delegated Regulation (EU) 2021/2268) that amended the previous Delegated Regulation ((EU) 2017/653) on the content and presentation of the key information document (**KID**).[78] It provided that it would apply from 1 July 2022 (except Article 1, point 13, which has applied since 1 January 2022);
- A regulation (Regulation (EU) 2021/2259)[79] to extend further the transitional arrangements for UCITS under the PRIIPS Regulation to 31 December 2022; and
- A Regulation amending the PRIIPS Regulation and a Directive for a 'quick fix' to amend the UCITS Directive (2009/65/EC), (both of which entered into force on 21 December 2021) to avoid duplicative pre-contractual arrangement requirements.

On 17 March 2022, the EU Commission adopted proposals for amendment to both Delegated Relegation (EU) 2017/653 and the PRIIPs KID Delegated Regulation**.** The amendments allow for PRIIPS manufacturers to provide a UCITS key investor information document (**KIID**) (rather than a PRIIPs KID) until 31 December 2022 (rather than 1 July 2022), and also amend the application date of the PRIIPs KID Delegated Regulation to 1 January 2023. As anticipated, the new Delegated Regulation was endorsed by the co-legislators following a scrutiny procedure that ended on 17 June 2022, and on 24 June 2022, Commission Delegated Regulation (EU) 2022/975 was published in the OJ. In a related statement, the EU Commission explains that the new Delegated Regulation extends transitional arrangements concerning the ability to use a KIID for the purposes of PRIIPs. The new Delegated Regulation also postpones the application date of certain PRIIPs-related disclosures to 1 January 2023, instead of 1 July 2022, as initially foreseen in Article 2(2) of Delegated Regulation (EU) 2021/2268. The new Delegated Regulation entered into force on 14 July 2022.

The EU Commission plans to review the PRIIPs Regulation as part of a wider holistic assessment of the different rules on disclosure and distribution to retail investors as part of the Capital Markets Union Action Plan (see Section 3.3 above) and the EU Commission's Retail Investment Strategy. Based on the outcome of this review, the EU Commission's original intention was to publish legislative proposals in Q2 2022 to improve the PRIIPs regime. However, a speech delivered by EU Commissioner McGuinness on 21 June 2022, indicated that the EU Commission will publish the Retail Investment Strategy in early 2023.

3.14 EU Digital Operational Resilience for the financial sector (DORA)

As part of the EU's digital finance package, the EU Commission adopted a legislative proposal[80] in September 2020 for a regulation on digital operational resilience for the financial sector. The aim is for participants in the EU financial sector to be subject to a common set of rules to mitigate information communication technology (**ICT**) risks. The EU Commission also published a draft directive to align certain existing EU financial services legislation

[78] Commission Delegated Regulation (EU) 2021/2268 is available here.

[79] Regulation (EU) 2021/2259 is available here.

[80] The legislative proposal for DORA is available here.

with DORA, which proposes amendments to operational risk or risk management propositions in AIFMD, UCITS Directive and MiFID II Directive (**Amending Directive**).

Digital operational resilience refers to financial institutions' ability to withstand ICT-related disruptions and threats, including cyber-attacks. The proposed regulation aims to establish a comprehensive digital operational resilience framework across the European banking, markets infrastructure, insurance and investment sectors, requiring financial entities to manage their ICT risks in a robust and effective way. It will also harmonise the current provisions in EU financial services legislation into one EU-level regulation, instead of the current range of different and inconsistent rules in different sectors and across Member States.

Under the proposals, financial entities will have to:

- Have internal governance and control frameworks that ensure they manage all ICT risks effectively;
- Have a robust ICT risk management framework;
- Report major ICT-related incidents to their competent authorities; and
- Manage ICT third-party risk within their ICT risk management framework.

Critical ICT third-party service providers providing services to financial entities will also be subject to a new oversight framework under DORA.

On 11 May 2022, the Council and the European Parliament announced that they had reached provisional political agreement on the proposed regulation. The provisional agreement is subject to approval by the Council and the European Parliament before going through the formal adoption procedure, but they are both expected to adopt the regulation.[81]

On 28 July 2022, the European Parliament published the texts of the provisional political agreements on the proposed DORA[82] and the Amending Directive.[83]

The next step is for the Council and European Parliament formally to adopt the proposals. The European Parliament's procedure files indicate that it is due to consider them during its plenary session to be held from 9 to 10 November 2022. The estimated date for approval of DORA by all parties is late 2022/early 2023, and the estimated date of the regulation and directive to come into effect in 2024/2025.

3.15 EU Regulation on Markets in Cryptoassets (MiCA)

As part of the EU's digital finance package, the EU Commission adopted a legislative proposal in September 2020 to create a harmonised framework for the regulation of cryptoassets across the EU, including a regulation on markets in cryptoassets (**MiCA**).[84] MiCA is intended to be innovation friendly and create a new EU legal framework for cryptoassets that are outside existing EU financial services legislation, and so currently unregulated, as well as introduce rules for stablecoins.

Trilogues between the co-legislators started on 31 March 2022, and on 30 June 2022, the Council and the European Parliament announced a provisional agreement on MICA, which covers issuers of unbacked cryptoassets and fiat-backed or fiat-referencing stablecoins, as well as the trading venues and the wallets where cryptoassets are held.

At the time of writing, a revised text of the legislative proposal has not yet been published.

Whilst the EU Commission's original September 2020 proposal for MiCA did not include 'providing portfolio management on cryptoassets' in the list of 'cryptoasset services', both the Council and European Parliament's

[81] The Council's press release is available here, and the Parliament's is available here.
[82] The texts of the provisional political agreement reached in trilogue negotiations for DORA is available here.
[83] The texts of the provisional political agreement reached in trilogue negotiations for the Amending Directive is available here.
[84] The current proposal for MICA and its Annexes is available here.

Economic and Monetary Affairs Committee (**ECON**) proposals did include portfolio management as a cryptoasset service. It is very likely that the final MiCA Regulation will include this activity as in scope of the MiCA regulation.

The next step is for the Council and the Parliament each to approve the political agreement before formally adopting MiCA.

For more information on the background to MiCA, see our OnPoint "Countdown to MiCA: The EU's cryptoassets regulation," available here and the Summer 2022 edition of the Horizon Scanner.

3.16 EU Securitisation Regulation

Under Article 46 of the Securitisation Regulation, the EU Commission is to submit a report on the functioning of the Securitisation Regulation to the European Parliament and to the EU Council by 1 January 2022. The EU Commission issued a consultation on these issues on 23 July 2021, which was open for feedback until 17 September 2021. For full details, see the Summer 2022 edition of the Horizon Scanner.

On 26 July 2022, the EU Commission published Commission Delegated Regulation (EU) 2022/1301 of 31 March 2022 in the OJ. The new regulation amends the regulatory technical standards laid down in Delegated Regulation (EU) 2020/1226 to reflect, in final form, the information to be provided in accordance with the STS notification requirements for on-balance-sheet synthetic securitisations. The regulation entered into force on 15 August 2022.

Questions and Answers: ESMA also updated its Q&As on the Securitisation Regulation on 19 November 2021.

There have been no significant developments since the publication of the Spring 2022 edition of the Horizon Scanner.

4. UK REGULATORY INITIATIVES

4.1 Is Brexit done? Not quite…

To help firms adapt to new post-Brexit requirements, HM Treasury gave UK financial regulators the power to make temporary transitional provisions in relation to financial services legislation – known as temporary transitional power (**TTP**) – and the use of the TTP is set out in FCA directions. Under the TTP, firms and other regulated persons can continue to comply with their pre-existing requirements for a limited period. However, the regulators' temporary transitional directions expired (for the most part) on 31 March 2022, meaning that regulatory requirements that were revised to accommodate Brexit now apply in full. The FCA has been clear in stating that it expected full compliance with on-shored regulatory obligations by 31 March 2022. In the run up to Brexit, the UK government and the FCA implemented a Temporary Permission Marketing Regime (**TMPR**) to allow investment funds with a passport to continue temporarily marketing in the UK. The FCA also established a Temporary Permission Regime (**TPR**) that allows EEA-based firms that were passporting into the UK at the end of the transition period (31 December 2020) to continue operating in the UK within the scope of their previous passport permission for a limited period after the end of the transition period. This is subject to having notified the FCA that they wanted to join the TPR before the end of the transition period. During this limited period, these firms must seek full authorisation by the PRA or the FCA in the UK, if required, to continue to access the UK market.

On 12 August 2022, the FCA updated its webpage on considerations for firms leaving the TPR to confirm that all firms expecting to apply for full authorisation in the UK should have received a formal direction confirming their landing slot. A firm may not have received a landing slot direction if the FCA is not expecting the firm to apply for full authorisation in the UK. Firms that do intend to apply for full UK authorisation and will be solo-regulated by the FCA, but who have not received a landing slot direction, can still apply, but any application must be received by the FCA before the end of 31 December 2022. Applications from firms in the TPR that are submitted to the FCA after 31 December 2022 will be treated as invalid.

The TMPR was originally due to end three years after the end of the transition period, however the FS Act extends this to five years (i.e., 31 December 2025) to allow enough time for government to complete any equivalence assessments and for funds in the TMPR to apply for recognition, either through the overseas fund regime (**OFR**)

(See Section 4.4 Proposals for an 'overseas funds regime' below), or section 272 of the Financial Services and Markets Act 2000 (**FSMA**).

On 14 July 2022, the FCA updated its webpage summarising the rules that apply to firms in the TPR and fund operators in the TMPR. The FCA has added a new section on disclosure requirements for EEA UCITS advising that:

- In the UK, the exemption from the requirement for EEA UCITS to produce a PRIIPs key information document (KID) lasts until **31 December 2026**. This exemption applies to both EEA UCITS recognised under section 272 of FSMA and those recognised under the TMPR. This means that, when being marketed to retail investors in the UK, EEA UCITS that are recognised under either section 272 of FSMA or the TMPR must produce a UCITS KIID; and
- The TMPR is due to end on **31 December 2025**. The FCA is engaging with HM Treasury on the disclosure requirements that would apply in the event of an equivalence decision under the UK overseas funds regime (**OFR**).

The text of the UK-EU memorandum of understanding on structured regulatory co-operation was agreed to in March 2021, but remains unratified, leaving some uncertainty as to the relationship between the UK and the EU on financial services.

Also note, on 9 February 2022, the EU Commission extended the temporary equivalence decision for UK CCPs to 30 June 2025 and will also bring forward measures to expand the capacity of EU CCPs. See the Summer 2022 edition of the Horizon Scanner for full details.

4.2 Financial Services Markets Bill 2022-23

On 20 July 2022, the Financial Services Markets Bill 2022-23 (the **Bill**)[85] was introduced to Parliament. The Bill is a lengthy 335 pages long and is accompanied by explanatory notes[86] that run to 237 pages. The Bill sets out the UK government's post-Brexit regulatory framework, as well as putting forward a number of proposals that make significant amendments to existing UK regulation.

The Bill establishes the framework as set out in the Future Regulatory Framework (**FRF**) review of moving retained EU law – which includes a large number of detailed regulatory requirements in the primary legislation – off the UK's statute books and onto the rulebooks of the UK Regulators (see 4.6 below). This would follow the existing FSMA model. It is important to note that the revocation of EU law is not immediate and would not take place until the FCA and/or PRA have drafted and consulted on replacement rules and those rules are ready to be put in place. This is a process that the government has indicated will take place over a period of years.

Other key provisions of the Bill include amendments to UK MiFIR (see 4.10 below), amendments to UK EMIR (see 4.12 below) and new regulatory powers, which include proposals to introduce (i) a Designated Activities Regime; (ii) a "regulatory gateway" for approving financial promotions (see 4.17 below); and (iii) proposals relating to Digital Assets. The Bill introduces a general rule-making power for the Bank over CCPs and CSDs, enabling it to take primary responsibility for setting the regulatory requirements for these entities.

The Bill also delivers the priority measures identified by the Wholesale Markets Review (**WMR**) consultation and aims to improve competitiveness and increase the flexibility of wholesale markets regulation by making nine sets of changes to the UK MiFID framework, including changes to the share trading obligation, alignment of the DTO under MiFIR with the EMIR clearing obligation and giving the FCA power to modify or suspend the DTO.

For further details, see our OnPoint "A New Regulatory Landscape? HM Treasury lays the Financial Services and Markets Bill 2022-23 before Parliament."

[85] The Bill, as introduced to the House of Commons on 20 July 2022, is available here.

[86] The explanatory notes, which relate to the Bill as introduced to the House of Commons on 20 July 2022 are available here.

The next stage in the legislative process is for the Bill to have its second reading in Parliament, currently scheduled for 7 September 2022.

4.3 Financial Services Act

The Financial Services Act 2021 (**FS Act**) was the first step in amending the UK's regulatory regime outside the EU. Amongst other things it:

- Establishes the legislative framework for the Investment Firms Prudential Regime (**IFPR**) and for the UK implementation of the final Basel III standards (See Section 4.5 for more details);
- Establishes the legislative framework for the Overseas Funds Regime (**OFR**) and makes amendments to the retained EU law version of the Markets in Financial Instruments Regulation (600/2014) (**UK MiFIR**) relating to the equivalence regime for third-country investment firms;
- Amends the retained EU law version of the Benchmarks Regulation ((EU) 2016/1011) (**UK BMR**) to provide the FCA with additional powers to manage an orderly wind-down of a critical benchmark, such as LIBOR (See Section 2 LIBOR for more details); and
- Amends the retained EU law version of the Market Abuse Regulation (596/2014) (**UK MAR**) and increases the maximum sentence for criminal market abuse.

For further details, see the Summer 2022 edition of the Horizon Scanner.

4.4 Proposals for an 'overseas funds regime'

Connected to the end of the Brexit transition period, HM Treasury consulted on proposals to simplify the process for allowing investment funds set up overseas to be marketed in the UK (**OFR**). Please refer to the January 2021 edition of the Horizon Scanner for full details of the OFR.

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

4.5 UK government to undertake a review of the UK funds regime

In the Spring 2020 Budget, the government announced a review of the UK funds regime to ensure its competitiveness and sustainability. This was envisaged to begin with a review of the VAT treatment of fund management fees (which is still awaited) and a consultation on the tax treatment of asset holding companies in fund structures to make the UK a more attractive location for such companies, as well as proposals for a UK Long Term Asset Fund (**LTAF**). This was followed by a 'Call for Input' from HM Treasury on 26 January 2021, setting out the objectives, scope and next steps for its review of the UK funds regime. Please refer to the April 2021 edition, the September 2021 edition and the Spring 2022 edition of the Horizon Scanner for full details of the Call for Input relating to the Review of the UK's fund regime and details of the LTAF.

In line with the May Regulatory Initiatives Grid,[87] on 1 August 2022, the FCA published a consultation paper on broadening (**CP22/14**) the distribution of the LTAF in a controlled way to a broader subset of retail investors. In CP22/14, the FCA sets out proposals for broadening the retail distribution of the LTAF to more categories of retail investors and pension schemes, while incorporating further investor protections. The FCA proposes to treat the LTAF as a Restricted Mass Market Investment (**RMMI**), in line with the FCA's policy statement (PS 22/10) on "Strengthening our financial promotion rules for high-risk investments" (see 4.17 below). The FCA states in CP22/14 that all firms that manufacture, manage or distribute the LTAF to retail investors and retail clients must comply with the Consumer Duty. (See 4.7 below).

[87] The Regulatory Initiatives Grid was developed as part of the FRF Review and prepared by Financial Services Regulatory Initiatives Forum, currently chaired by the CEO of the FCA and the Deputy Governor of the BoE. The Grid is intended to provide a clear picture of expected regulatory activity to help regulators, firms and consumer stakeholders plan ahead. The most recent iteration of the Grid was published in May 2022 and is available here.

On 10 February 2022, HM Treasury published its "Review of the UK Funds Regime – summary of responses," which sets out the next steps in the review of the UK funds regime. The government, and the FCA where applicable, confirms that it proposes to:

- Make the taxation of funds simpler and more efficient, including in relation to the genuine diversity of ownership (**GDO**) requirement, REITs and solutions to deal with the tax efficiency of multi-asset authorised funds;
- Expand the range of investment products available in the UK, including in relation to authorised fund structures that are permitted to distribute capital, and a new type of fund structure – an unauthorised contractual scheme – aimed at professional investors; and
- Explore opportunities to support the wider funds environment, including by providing additional information on the fund authorisation process and by promoting the UK funds regime abroad.

In addition to these reforms, the review states that government, and the FCA where applicable, will also be working to enhance the UK funds regime through:

- A consultation on options to simplify the VAT treatment of fund management fees; and
- Ongoing work to facilitate the rollout of the LTAF, including: the continued work of the Productive Finance Working Group; a planned FCA consultation on changing restrictions on the promotion of LTAFs to retail investors; and continued assessment of the way LTAFs are taxed.

Qualifying Asset Holding Companies (**QAHC**) legislation has been implemented in the Finance Act with effect from April 2022. The QAHC will benefit from a variety of tax exemptions, including from capital gains on disposals of assets, UK withholding tax, stamp duty and SDRT on redemptions of shares and exemptions from various provisions that would otherwise disallow a tax deduction for payments made on funding instruments. Redemptions of shares in a QAHC should also qualify for capital gains treatment in a wider range of circumstances. The QAHC will also only pay tax on a modest amount of corporation tax on a transfer priced profit attributable to the extent of its activities (which are envisaged to be limited). There will be conditions attached to the circumstances when a company can elect to be a QAHC (and it will be mandatory to elect into the regime). In particular, QAHCs must not have more than 30 percent ownership by non-qualifying investors. Qualifying investors would include a variety of qualifying funds and institutional investors. Further, the QAHC may not carry on a trading activity. HMRC has provided some updated helpful guidance particularly in relation to credit funds as to the activities which would or would not be likely to be regarded as a trading activity. Loan origination of itself should not be so regarded. Further changes have also been introduced into the legislation to assist parallel and feeder funds to meet the qualifying criteria. Reference should be made to the legislation for further information.

4.6 Future Regulatory Framework Review

A number of strategic reviews are underway to enhance the UK's regulatory framework, including the Future Regulatory Framework Review (**FRF**). Please refer to the Spring 2022 edition and the Summer 2022 edition of the Horizon Scanner for full details of the FRF. The FSM Bill (see 4.2 above) will legislate for these reforms.

4.7 A new Consumer Duty

In May 2021, the FCA consulted (**CP21/13**)[88] on proposals for a new consumer duty (the **Duty**), followed by a second consultation in December 2021 (**CP21/36**).[89]

The FCA's policy statement (**PS22/9**)[90] has now set out final rules. .[91] These comprise:

- A new Consumer Principle that requires firms to act to deliver good outcomes for retail customers;
- Cross-cutting rules providing greater clarity on FCA expectations (see below); and

[88] CP21/13 is available here.
[89] CP21/36 is available here.
[90] PS22/9 is available here.
[91] The FCA Final non-Handbook Guidance for firms on the Consumer Duty are available here.

- Rules relating to the four outcomes the FCA wants to see under the Duty, relating to (i) products and services; (ii) price and value; (iii) consumer understanding; and (iv) consumer support.

The Duty applies to firms that can determine or materially influence retail customer outcomes. The Duty applies proportionately based on what is reasonable in the circumstances and in a manner that reflects the firm's role in the distribution chain and its ability to influence retail customer outcomes. Following concerns raised by wholesale market participants, the FCA has clarified that products or services that are not designed for retail customers are not in scope of the Duty where they:

- Are only marketed and approved for distribution to non-retail customers; and
- Are not provided to another firm under an arrangement between them as part of a distribution chain for a retail product or service.

Thus, the fund manager of an institutional investor-only fund would not be subject to the Duty if a third party, without its involvement, invests into the institutional fund via a retail fund of funds.

The rules and related guidance come into force on a phased basis:

- For new and existing products or services that are open to sale or renewal, the rules come into force on 31 July 2023; and
- For closed products or services, the rules come into force on 31 July 2024.

The FCA expects that:

1. By the **end of October 2022**, firms' governing bodies boards should have agreed their implementation plans.
2. Manufacturers should aim to complete all the reviews necessary to meet the four outcome rules for their existing open products and services by the **end of April 2023**, so that they can: share relevant information with distributors and identify any changes that need to be made by 31 **July 2023**.
3. Where firms identify serious issues causing immediate consumer harm, they should prioritise action to remedy this.
4. Where actions to bring products and services up to Duty standards can be completed more quickly than the implementation deadlines, firms should consider doing so.
5. In line with Principle 11 (Relations with Regulators), firms should engage with the FCA if, as part of the implementation of the Duty, they are considering withdrawing or restricting access to products or services in a way that will have a significant impact on vulnerable consumers or on overall market supply.
6. Governing bodies should maintain oversight of their firms'' implementation plans.
7. Firms must alert the FCA (as required by SUP 15.3.11R) if they believe that they will not be able to complete all work necessary to be compliant with the Duty before the implementation deadlines. The FCA expects firms to be compliant, but firms should also take a risk-based approach and prioritise the implementation work that is likely to have the biggest impact on consumer outcomes.
8. At the end of implementation period, governing bodies should satisfy themselves that their firms are complying with their obligations under the Duty, and have identified any gaps or weaknesses in their compliance and any action needed to remedy this.

4.8 UK prudential regime for investment firms (IFPR)

The IFPR is a revised prudential regime for FCA-authorised investment firms based on – but not identical to – the Investment Firms Regulation (**IFR**) and the Investment Firms Directive (**IFD**) (see Section 3.8 above). The IFPR took effect on 1 January 2022. The IFPR provisions are mainly contained in the Prudential sourcebook for MiFID

Investment Firms (**MIFIDPRU**) of the FCA Handbook. Details of IFPR are given in the Spring 2022 edition and September 2021 edition of the Horizon Scanner.

Although the regime took effect on 1 January 2022, the FCA is applying transitional provisions (contained in MIFIDPRU) to the IFPR similar to those set out in the IFR, intended to ease the change from existing capital requirements to the tougher IFR capital requirements.

The FCA webpage[92] contains links to the relevant MIFIDPRU forms as well as template Remuneration Policy Statements to help firms record how their remuneration policies comply with the MIFIDPRU Remuneration Code.

The May Regulatory Initiatives Grid indicates that in Q4 2022 the FCA will consult on ESG disclosures, own funds CRR copyout and integration into MIFIDPRU and on certain MIFIDFPRU clarifications.

In terms of recent developments, on 16 August 2022 the FCA clarified[93] aspects of its new IFPR rules. When introducing the IFPR in January 2022, the FCA renamed and moved the definition of 'Significant IFPRU firm' used as one of the criteria for identifying Enhanced Firms under the SM&CR. This was to retain the definition in the FCA's rules following deletion of the IFPRU sourcebook. However, the new definition of 'Significant SYSC firm' would result in more firms being brought into 'Enhanced Scope' than under the 'Significant IFPRU firm' definition.

The FCA therefore plans to clarify that only firms that would have been both Significant IFPRU firms and IFPRU investment firms under the pre-IFPR arrangements fall within the new definition of 'Significant SYSC firm' for the purposes of the Enhanced Scope SM&CR regime. In the meantime, firms that have unintentionally come under the Enhanced Scope SM&CR Regime need take no action.

4.9 UK MiFID

The UK Markets in Financial Instruments Directive regulates the buying, selling and organised trading of financial instruments. It derives from EU legislation that first took effect in November 2007 and was significantly amended in January 2018 (**MiFID II**). The UK version of MiFID II is referred to as UK MiFID.

There have been no recent significant developments on UK MiFID since the Spring 2022 edition of the Horizon Scanner.

4.10 UK MiFIR

The retained EU law version of the Markets in Financial Instruments Regulation (600/2014) (UK MiFIR) has applied in the UK since the end of the Brexit transition period.

There have been no recent significant developments on UK MiFIR since the Summer 2022 edition of the Horizon Scanner.

4.11 UK Short Selling Regulation

The UK 'on-shored' the EU Short Selling Regulation by way of a Statutory Instrument (**SI**), meaning that the UK now has its own version of the Short Selling Regulation (the **UK SSR**). Since February 2021, the UK SSR has mandated a 0.1 percent reporting threshold, which is the same as the threshold in the EU SSR.

Please refer to the September 2021 edition of the Horizon Scanner for further details.

There have been no significant UK SSR developments since September 2021.

4.12 UK EMIR

The FCA has webpages dedicated to UK EMIR and EU EMIR news and key aspects of UK EMIR. See the Summer 2022 edition of the Horizon Scanner for details of prior post-Brexit amendments to UK EMIR.

---

[92] The FCA's IFPR webpage is available here.
[93] The FCA statement is available here.

Clearing obligation – further global benchmark reform prompted updates: On 9 June 2022, the BoE published a consultation paper on the "Derivatives clearing obligation – modifications to reflect USD interest rate benchmark reform: Amendments to BTS 2015/2205."[94] The consultation set out the proposals to modify the scope of contracts that are subject to the derivatives clearing obligation (**DCO**), by adding OIS that reference SOFR and removing contracts referencing USD LIBOR.

On 24 August 2022, the BoE published a Policy Statement and Technical Standards Instrument[95] that maintains the proposal in the June consultation namely:

- To add OIS contracts that reference SOFR (to come into force on 31 October 2022) and subsequently to remove contracts that reference USD LIBOR (to come into force around the same time) as a number of CCPs contractually convert these contracts and remove them from their list of contracts eligible for clearing;
- A minimum maturity for the SOFR OIS contract type of seven days (as opposed to 28 days for the USD LIBOR contracts currently subject to the clearing obligation); and
- In the June consultation, the BoE proposed to align the date on which USD LIBOR contracts will be removed from the DCO with CCPs contractual conversions of those contracts (which the BoE anticipated would occur in Spring 2023). Consistent with that proposal, contracts referencing USD LIBOR will be removed from the DCO on 24 April 2023. The BoE confirmed this date will not change, irrespective of any potential changes to the CCPs' contractual conversions announced subsequent to the policy statement.

The appendix to the policy statement contains the Bank Standards Instrument: The Technical Standards (Clearing Obligation) Instrument 2022, which amends the on-shored version of Commission Delegated Regulation (EU) 2015/2205 supplementing EMIR with regard to regulatory technical standards on the clearing obligation (that is, Binding Technical Standards (BTS) 2015/2205).

Margin requirements: In line with the timing set out in the FCA's May Regulatory Initiatives Grid on 12 July 2022, the PRA and FCA are consulting on UK EMIR margin requirements for non-centrally cleared derivatives, "Margin requirements for non-centrally cleared derivatives: Amendments to BTS 2016/2251."[96] The consultation focuses on: (i) the treatment of third-country funds as eligible collateral, including EEA UCITS; (ii) a fallback transitional period where firms face immediate application of the bilateral margining requirements; and (iii) updates to the criteria for a CCP to be excluded from the margin requirements. The consultation closes on 12 October 2022. Following consideration of any responses, the PRA and FCA will submit the updated BTS 2016/2251 to HMT for approval. The PRA and FCA will then make the amendments to the technical standards.

UK EMIR REFIT: The FCA has indicated that HM Treasury, FCA and BoE plan to complete the implementation of the UK EMIR REFIT, designed to improve trade repository data and ensure that firms are able to access clearing services on fair and reasonable terms. The FCA has provisionally outlined that they expect go-live to occur around September/October 2024.

Reporting requirement: In November 2021, the BoE and FCA issued a consultation paper (CP 21/31)[97] on "Changes to reporting requirements, procedures for data quality and registration of Trade Repositories (**TR**) under UK EMIR." CP21/31 includes an express statement relating to "*predominant alignment"* with the ESMA December 2020 final report on reporting, but it also flags that there are a small number of areas that diverge. These are highlighted in the paper together with reasons for such divergence. CP 21/31 also acknowledges that the EU-amended rules are yet to be finalised, and the FCA will consider any changes. The consultation closed on 17 February 2022. A Policy Statement was expected in Summer 2022 and supporting documentation and validation rules in or around Q4 2022.

[94] The BoE consultation is available here.
[95] The Policy Statement is available here.
[96] The consultation is available here.
[97] CP21/31 is available here.

Non-UK central counterparties: On 30 June 2022, the BoE published a statement of policy (**SoP**)[98] and a policy statement[99] on its approach to comparable compliance under Article 25a of UK EMIR. The SoP sets out the BoE's approach to granting comparable compliance to certain non-UK central counterparties (incoming CCPs) recognised to provide clearing services to clearing members or trading venues established in the UK. The BoE will implement its approach to comparable compliance from 1 December 2022.

4.13 UK SFTR

SFTR was on-shored under the European Union (Withdrawal) Act 2018. A dedicated FCA webpage for UK SFTR includes a note the FCA published in November 2020 on the application of UK SFTR reporting. Please refer to the April 2021 edition and the Summer 2022 edition of the Horizon Scanner for further details on UK SFTR.

4.14 UK PRIIPS

The EU PRIIPs Regulation has applied across the EU since 1 January 2018. Like other directly applicable EU legislation, it became part of UK law at the end of the Brexit transition period (**UK PRIIPS**). Both the EU and UK PRIIPS Regulations set the requirements for a standardised disclosure document, known as KID, that must be provided to retail investors when they purchase particular packaged retail investment products (**PRIIPs**).

Importantly for asset managers, Article 32 of the UK PRIIPs Regulation contains a temporary exemption from the obligations under the UK PRIIPs Regulation for UK and EEA UCITS, meaning that these entities do not need to draw up or provide KIDs to UK retail investors. Instead, they are expected to prepare or provide KIIDs under the UCITS disclosure regime. The exemption was due to expire on 31 December 2021, but the FS Act gave HM Treasury the power to make regulations that further extend the exemption for UCITS until no later than 31 December 2026.

Previous developments in relation to UK PRIIPs are discussed in the September 2021 edition, the Spring 2022 edition and the Summer 2022 edition of the Horizon Scanner.

In March 2022, the FCA published a policy statement (**PS22/2**)[100] setting out amendments to the UK PRIIPs disclosure regime, amending to the existing disclosure requirements in the FCA Handbook and the PRIIPs Regulatory Technical Standards (**UK PRIIPs RTS**).

PS22/2 also states that the FCA will also make consequential date changes to the UK PRIIPs RTS and Handbook rules to align with the extension of the UCITS exemption in the on-shored UK PRIIPs Regulation to 31 December 2026. As noted in 4.1 above, the FCA has confirmed that the exemption from the requirement for EEA UCITS to produce a PRIIPs KID lasts until **31 December 2026**. The exemption applies to both EEA UCITS recognised under section 272 of FSMA and under the TMPR.

The Handbook rules and UK PRIIPs RTS came into force on 25 March 2022, with a transition period that will end on 31 December 2022, after which firms must apply the new requirements. A further amendment was made to Annex VI (Methodology for the calculation of costs) of the UK PRIIPs RTS regarding (a) the treatment of anti-dilution mechanisms, (b) the summary cost indicator and (c) the compound effect of costs for all types of PRIIPS. HM Treasury has stated that it will "*conduct a more wholesale review of the disclosure regime for UK retail investors*," which will include a more holistic review of the UK PRIIPs regime.

4.15 UK Benchmarks Regulation (UK BMR)

The FS Act (see 4.3 above) makes amendments to the UK BMR. The FCA has published a document entitled "Benchmarks Regulation and amendments under the Financial Services Act 2021"[101] that summarises the amendments.

---

[98] The SoP is available here.

[99] The Policy Statement is available here.

[100] PS22/2 is available here.

[101] The "Benchmarks Regulation and amendments under the Financial Services Act 2021" paper is available here.

4.16 UK Securitisation Regulation

On 24 June 2021, HM Treasury published a call for evidence on the retained version of the EU Securitisation Regulation ((EU) 2017/2402) (**UK Securitisation Regulation**), discussed in the September 2021 edition of the Horizon Scanner.

On 13 December 2021, HM Treasury published its report and call for evidence response. The report and conclusions are discussed in the Spring 2022 edition of the Horizon Scanner.

The FSM Bill (see 4.2) will make amendments to the UK Securitisation Regulation. Certain securitisations can be designated as Simple, Transparent and Standardised (**STS**). STS equivalent non-UK securitisations can be recognised in the UK if HM Treasury is satisfied that the law and practice that applies in the country applicable to the securitisations has equivalent effect to UK law and there are effective cooperation arrangements with the competent authorities in that territory. HM Treasury will need to make a regulation in relation to designating a third country or territory as equivalent, which can include additional diligence requirements for investors.

4.17 HM Treasury and FCA proposals to amend the financial promotions approval regime

As discussed in the January 2021 edition of the Horizon Scanner, in July 2020, HM Treasury announced a consultation on limiting the scope of firms that can approve the financial promotions of unauthorised persons.

To recap, the FCA consulted on proposals to amend the financial promotion approval regime by establishing a regulatory gateway for the approval of unauthorised persons' promotions. The FCA published a consultation paper (**CP22/2**)[102] setting out the FCA's proposed amendments to complement the section 21 gateway. It also set out proposals for strengthening financial promotion rules for high-risk investments (**HRI**) and for firms approving financial promotions. Full details of the consultations are available in the Summer 2022 edition of the Horizon Scanner.

On 1 August 2022, the FCA published a policy statement (**PS22/10**)[103] on strengthening its financial promotion rules for high-risk investments and firms approving financial promotions and summarising the responses to CP 22/12. PS22/10 also contains the final rules, and non-Handbook Guidance, for firms when communicating or approving financial promotion. Following feedback and responses the FCA has made changes to its original CP22/12 proposals, which are intended to address concerns identified by respondents to CP22/12 and to give firms time to ensure an orderly implementation.

The rules relating to risk warnings for financial promotions of HRIs take effect from **1 December 2022**. All other rules take effect from **1 February 2023**.

The FCA also notes that since CP22/2 was published, the Consumer Duty rules have been published (see 4.7 above) and the financial promotion rules set out in PS22/10 support the FCA's approach of the Consumer Duty. The strengthened financial promotion rules set a minimum baseline for firms that promote HRI and give guidance on what is expected, with the aim of bringing up the overall standard of HRI promotions. The new rules also support the Consumer Duty, by encouraging firms to consider for themselves whether they should go beyond this minimum standard.

In CP22/2, the FCA set out its proposed rules for cryptoasset promotions. In PS22/10 the FCA confirms that final rules on the promotion of qualifying cryptoassets will be made once the relevant legislation has been made.

Separately, the FCA has published a consultation paper on broadening retail access to the LTAF (CP22/14). In CP22/14, the FCA proposes to classify the LTAF as a restricted mass market investment (**RMMI**), based on the rules set out in PS22/10.

[102] Consultation Paper 22/2 is available here.

[103] PS22/10 is available here.

4.18 Appointed Representatives regime

In its November 2021 Regulatory Initiatives Grid,[104] the FCA and HM Treasury stated that they would engage with stakeholders to understand more about the Appointed Representatives regime and address known issues and harms.

An Appointed Representative (**AR**) is a firm[105] or person who carries on regulated activities under the supervision of an authorised financial services firm (a **principal**), with the principal assuming responsibility for the regulated activities carried on by the AR.

On 3 December 2021, the FCA published a consultation paper (**CP21/34**)[106] on improving the AR regime. For further details on the proposals to improve the AR regime, see the Spring 2022 edition of the Horizon Scanner.

On 3 August 2022, the FCA published a policy statement (**PS22/11**)[107] on improvements to the AR regime. Pursuant to the new rules, principals will need to:

- Notify the FCA of future AR appointments 30 calendar days before they take effect;
- Provide complaints data and revenue information for ARs to the FCA on an annual basis;
- Apply enhanced oversight of their ARs, including ensuring adequacy of systems and controls, sufficiency of resources and monitoring AR growth;
- Take more effective responsibility for their ARs, including by monitoring and assessing the risk of harm to consumers and market integrity and overseeing ARs to a comparable standard as if they were employees of the principal; and
- Annually review information on ARs' activities, business and senior management and be clear on the circumstances when they should terminate an AR relationship. Principals would also need to prepare a self-assessment document at least once a year, covering how they meet the requirements of the policy.

In terms of scope, the rules will affect all firms that have ARs as well as ARs themselves. The FCA has not applied these rules to firms in the TPR or the Financial Services Contracts Regime (**FSCR**). Firms in the TPR or FSCR remain subject to relevant rules as set out in Chapter 2 of the General Provisions in the FCA Handbook.

CP21/34 proposed requiring principals to notify the FCA of an intention to begin providing regulatory hosting services, and to require all existing principal firms to notify the FCA if they already provide such services. Hosting firms will need to notify the FCA of their intention to provide such service 60 days in advance. In PS22/11, the FCA expressly states that it is "*not imposing any additional rules or restrictions on firms which provide such services at this time*". The FCA has narrowed the original proposed definition of 'regulatory hosting' so that it is now focused on instances where the host is providing its hosting services for remuneration with a view to profit and either (i) does not carry on any regulated activities other than through its AR or (ii) the regulated activities carried on by one or more of the host's ARs are not connected to any regulated activity undertaken by host other than through its ARs.

PS22/11 includes the FCA's final Handbook rules and guidance and updated forms. The changes set out in PS22/11 will take effect on **8 December 2022,** and the FCA has put in place transitional arrangements.

To ensure that they are prepared for the changes Principals are advised to take action now, including:

- Reviewing their contractual arrangements with ARs to ensure the written contract allows the principal to terminate the agreement with the AR in certain specified circumstances and to ensure that the principal has

[104] The Grid is available here.

[105] "Firm" being the plain English purposes and refers to any for-profit business entity, rather than the definition given in the FCA Handbook.

[106] CP 21/34 "Improving the Appointed Representatives regime" is available here.

[107] PS22/11 is available here.

the ability to exercise oversight of the activities of the AR. (This is a new specific "Contracts: required term" provision under SUP 12.5);

- Looking at their existing systems and controls to ensure that thy are able to apply enhanced oversight of their ARs and amend or introduce new systems as necessary. Principals should also ensure they have clear processes for the escalation of issues, for example, grading of issue severity based on impact and potential harm to clients and processes for remediation within defined timeframes. If appropriate, such expectations should be included in the contract agreement between the principal and AR; and
- Ensuring that they have access to the necessary information to be able to report to the FCA. This will require principals to review their contractual agreements with ARs and amend those agreements where necessary.

Amendments to existing contractual agreements only need to be made to comply with the new AR obligations at the first renewal or revision point for the agreement after 8 December 2022.

4.19 Regulation of cryptoassets

In 2018, the government launched a cross-authority Cryptoassets Taskforce with the aim of exploring the impact of a rapidly developing cryptoasset market. At the time, the Cryptoassets Taskforce judged that the cryptoasset market was at an immature stage of development, and that there was limited evidence of the current generation of cryptoassets delivering benefits.

Four years on, the landscape is changing. A large proportion of cryptoassets are likely to fall outside the regulatory perimeter, meaning they may not be subject to the same consumer protections or safeguards found in other areas of financial services, and payments and regulation of cryptoassets is on the agenda. The FCA says that "*Cryptoassets are a very high-risk investment that we don't regulate*." On 7 January 2021, HM Treasury launched a consultation on the broader regulatory approach to cryptoassets with a deadline for comments of 21 March 2021.[108] The proposals include the introduction of a new regulated category of cryptoasset known as stable tokens. These are tokens that stabilise their value by referencing one or more assets, such as fiat currency or a commodity, and can for that reason more reliably be used as a means of exchange or store of value.

On 4 April 2022, HMT published its response to the consultation.[109] The government proposes to bring stablecoins – where used as a means of payment – within the payments regulatory perimeter, creating a regulatory basis for stablecoin issuers and service providers to operate in the UK. See the Summer 2022 edition of the Horizon Scanner for full details.

The FSM Bill (see 4.2 above) will bring activities facilitating the use of certain stablecoins, where used as a means of payment, into the UK regulatory perimeter, primarily by amending the existing electronic money and payment system regulatory frameworks.

On 13 July 2022, the UK Parliament's Treasury Committee launched a new inquiry and call for evidence into the cryptoasset industry. In the inquiry, the Committee will explore the role of cryptoassets in the UK, as well as the opportunities and risks they bring to consumers and businesses.

The inquiry will cover:

- The role of cryptoassets in the UK, including the opportunities and risks that cryptoassets may bring to consumers, businesses and the UK government (and associated bodies);
- The potential impact of distributed ledger technology on financial institutions, including the central bank, and financial infrastructure; and

[108] The consultation is available here.
[109] The response to the consultation is available here.

- The regulatory response to cryptoassets from the UK government, the FCA and the BoE, considering how regulation could be balanced to provide adequate protection for consumers and businesses without stifling innovation.

The Committee is inviting written submissions on many issues, including:

- To what extent are cryptoassets when used as digital currencies (such as stablecoins) likely to replace traditional currencies?
- What opportunities and risks would the introduction of a Bank of England Digital Currency bring? (See 4.22 below for details of the UK's CBDC).
- What impact could the use of cryptoassets have on social inclusion?
- Are the UK government and regulators suitably equipped to grasp the opportunities presented by cryptoassets, whilst at the same time mitigating against the risks?
- What opportunities and risks could the use of cryptoassets – including Non-Fungible Tokens – pose for individuals, the economy and the workings of both the public and private sectors?
- How can distributed ledger technology be applied in the financial services sector?

Written submissions can be made up to 12 September 2022.

4.20 Cryptoasset promotion

The Cryptoassets Taskforce published a report in 2018, which found that misleading advertising and a lack of suitable information was a key consumer protection issue in cryptoasset markets. Cryptoasset advertising, which is often targeted at retail investors, often overstates benefits and rarely warns of volatility risks.

In a July 2020 consultation paper, HM Treasury proposed amendments to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529) (**FPO**) to bring certain types of unregulated cryptoassets within its scope. Not all cryptoassets would be caught as the government considers that applying the financial promotion regime too broadly could stifle innovation without a proportionate benefit to consumer protection. The consultation proposed to define relevant cryptoassets as controlled investments and unregulated cryptoassets as "qualifying cryptoassets."

On 18 January 2022, the government published its response[110] to the July 2020 consultation. It noted respondents agreed that there are consumer risks in the cryptoassets market, and there was a case for intervention. The government response also clarified how HM Treasury intends to define "qualifying cryptoasset."[111]

Further details are set out in the Spring 2022 edition of the Horizon Scanner.

In January 2022, the FCA published CP 22/2 (also discussed at 4.17 above) which, amongst other things, set out financial promotion rules for high-risk investments (**HRIs**), including cryptoassets. "Qualifying cryptoassets" will be brought within the scope of the financial promotion regime and subject to similar requirements to other HRIs. For example, cryptoassets will need to comply with the requirement for financial promotions to be clear, fair and not misleading, and with COBS 4. The FCA confirms in PS22/10 (discussed in 4.17 above) that it will make final rules on the promotion of qualifying cryptoassets once the relevant legislation has been made. These rules are likely to follow the same approach as for other HRIs as the FCA considers cryptoassets, when used as a speculative investment, to be high-risk.

[110] The January 2022 response to the CP is available here.

[111] HM Treasury confirmed in its January 2022 consultation response that it intends to define 'qualifying cryptoasset' as "*any cryptographically secured digital representation of value or contractual rights which is fungible and transferable.*"

4.21 AML5 and Cryptoassets

In 2020, the government and the FCA implemented the Fifth Anti-Money Laundering Directive for cryptoassets, which brought custodian wallet providers and cryptoasset exchange providers into anti-money laundering and counter-terrorist financing regulation.

Since 10 January 2020, the FCA has been the anti-money laundering and counter-terrorist financing (**AML/CTF**) supervisor of UK cryptoasset businesses under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, as amended (**MLRs 2017**). The FCA has a detailed webpage on the AML/CFT regime for cryptoassets.[112]

In recent developments, the FCA has expanded its change in control regime to include FCA-registered cryptoasset businesses. From 11 August 2022, any person who decides to acquire 25 percent or more control of an FCA-registered cryptoasset firm must receive prior FCA approval before completing the transaction. Failure to obtain FCA approval if required is a criminal offence. The obligation arises by virtue of new provisions in the MLRs 2017, which apply Part 12 of FSMA to cryptoasset businesses, with some modifications.[113] The changes give the FCA the opportunity to undertake a "fit and proper" assessment of the proposed controller, as well as the power to object to the transaction and to make its reasons for objecting public. On 11 August 2022, the FCA updated its webpage on change in control notification forms to include links to the relevant forms for use by persons intending to acquire control over an FCA-registered cryptoasset firm.

For more information, see the Spring 2022 edition of the Horizon Scanner.

4.22 Central Bank Digital Currency

The BoE and HM Treasury established a Joint Taskforce in April 2021 to consider introducing a UK 'retail' central bank digital currency (**CBDC**). CBDC would be a form of electronic money issued by the BoE that could be used by households and businesses to make everyday payments – in essence a 'digital banknote.' In November 2021, the CBDC Joint Taskforce announced that they would consult in 2022 on their assessment of the case for a UK CBDC. At the time of writing the consultation has not been launched. The BoE has a webpage dedicated to CBDC.

For more details on the CBDC, see the Spring 2022 edition of the Horizon Scanner.

4.23 Review of the UK's AML/CFT regulatory and supervisory regime

As noted in the September 2021 edition of the Horizon Scanner, in July 2021, HM Treasury published a Call for Evidence on the UK AML and CTF regulatory regimes. The MLRs 2017 required HM Treasury to publish this report no later than 26 June 2022.

On 24 June 2022, HM Treasury published two post-implementation reviews and a forward-looking review of the UK's AML/CFT regime.[114] The post-implementation reviews cover the MLRs 2017 and also the Office for Professional Body AML Supervision Regulations (**OPBAS**), fulfilling HM Treasury's statutory obligations. In the works of HM Treasury the forward looking review is focused on *"improving the effectiveness of the [MLRs 2017], ensuring the application of effective risk-based controls across the regulated sector and developing a world-class AML supervisory regime."*

The review is structured around three key themes:

- **Systemic Effectiveness**: ensuring that as the government works to reform and improve the UK's regime, a definition of what effectiveness looks like and some proposals on how this can start to be measured with more precision has been agreed;

---

[112] The FCA's AML/CFT regime for Cryptoassets is available here.

[113] The statutory instrument making the change is available here.

[114] The Policy Paper is available here.

- **Regulatory Effectiveness**: ensuring that those firms and individuals on the front line of the UK's fight against illicit finance are well-equipped, with a strong risk understanding and capability to implement effective risk-based controls within their business, as well as the scope to target that activity at areas of highest risk; and
- **Supervisory Effectiveness**: continuing reform of the supervision regime, building on the improvements made in recent years while assessing the rationale for further structural change to the regime.

In the forward-looking review, HM Treasury includes the following statements:

- The government has refined further the objectives for the MLRs 2017 proposed in the Call for Evidence based on evidence gathered. The overall link to the FATF methodology will be retained, with amendments;
- The government will be setting out wider 'outcomes-focused' metrics as part of the updated Economic Crime Plan later in 2022;
- The government has concluded that there is insufficient evidence at the current time for a fundamental overhaul of the preventative measures required under the MLRs 2017, and that increasing consistency of compliance with the current requirements should be a priority in order to increase the overall effectiveness of the MLRs 2017;
- The government is not minded to shift fundamentally the balance of mandatory requirements under the MLRs 2017. It will work with supervisors and OPBAS to understand how small and newly regulated firms are currently supported to fulfil their obligations, and whether there is any additional support that could be offered, while remaining mindful of the need for both the supervisory approach and the approach taken by those firms to remain risk-based. The government will work with supervisors, OPBAS and law enforcement agencies to understand how information and intelligence are currently shared, whether this is useful and how these methods might be enhanced as well as where existing structures are less useful or providing less value;
- The government is committed to doing further work to better understand the risk profile of domestic politically exposed persons (**PEPs**);
- The government is not minded to make any changes to the definition of "correspondent relationships" in the MLRs 2017;
- The government continues to think it proportionate to maintain a list of High-Risk Third Countries on which mandatory enhanced due diligence (**EDD**) is required. It does not plan to make changes to the components of simplified due diligence (**SDD**), or the description of flexibility currently given in the MLRs 2017;
- The government will review the wording "Complex or unusually large transactions" which are subject to the requirement to do EDD and enhanced ongoing monitoring, and consider whether an alternative provision would more clearly deliver the policy intent; and
- The government plans to consult on options to address the difficulties in accessing Pooled Client Accounts (**PCAs**), including the option of broadening the range of low-risk circumstances in which PCAs may be provided without checks being required on the clients whose funds are held in the account.

In the forward looking review, the government also confirms it is committed to continuing to identify and address deficiencies in the supervision regime. Given the extent of the proposals, the government is not proposing a single model to pursue at this stage. A formal consultation will be issued in order to understand better the implications and practicalities of each model, before deciding on any option.

Any changes will take place over a period of years, particularly for major structural reform. In the interim, the government will continue to work with supervisors to improve supervisory effectiveness and ensure that more short-term improvements are still achieved while longer term reform is considered.

5. U.S. REGULATORY INITIATIVES

5.1 SEC announces Spring 2022 Regulatory Agenda

The Office of Information and Regulatory Affairs published its Spring 2022 Unified Regulatory Agenda on 22 June 2022 (the **Agenda**). The Agenda lists short- and long-term regulatory actions that U.S. administrative agencies, including the Securities and Exchange Commission (**SEC**), plan to take. The Agenda indicates a number of upcoming regulatory reviews and changes that will affect private funds and their managers. The SEC's rulemaking list can be viewed here.

Proposed Rule Stage:

- **Exempt Offerings**. The Division of Corporation Finance is considering recommending that the SEC seek public comment on ways to further update the SEC's rules related to exempt offerings. The particular focus appears to lie with ways to more effectively promote investor protection and might include updating the financial thresholds in the accredited investor definition, ensuring appropriate access to and enhancing of the information available regarding Regulation D offerings, and amendments related to the integration framework for registered and exempt offerings;
- **Custody Rule**. The Division of Investment Management is considering recommending that the SEC propose amendments to the Custody Rule (Rule 206(4)-2 under the Investment Advisers Act of 1940 (the **Advisers Act**)) and/or propose new rules under the Advisers Act that will seek to improve and modernise the regulations around the custody of funds or investments of clients by Investment Advisers. While it is not known exactly what will be included, it may address certain issues raised by the SEC in a comment solicitation in March 2019 that sought information on digital assets and non-delivery-versus-payment transactions; and
- **Form PF Amendments.** The Division of Investment Management is considering recommending that the SEC propose additional amendments to Form PF. Based on comments from Chair Gensler in January 2022, we know that the SEC Staff has been working with the CFTC to consider amending the joint portions of Form PF, and proposed amendments could be forthcoming in the upcoming months.

Further information: as updates in relation to any of the above actions on the Agenda move forward, Dechert will provide further updates.

5.2 Substantial overhaul of the SEC Advertising and Solicitation Rules

The SEC has finalised its amendments to Rule 206(4)-1 – Advertisements by Investment Advisers (**Old Advertising Rule**) and Rule 206(4)-3 – Cash Payments for Client Solicitations (**Old Solicitation Rule**) under the Advisers Act, as well as technical amendments to Rule 204-2 (the **Recordkeeping Rule**) and Form ADV, Part 1A (separately, **Updated Advertising Rule** and **Updated Solicitation Rule**, and collectively, **New Rules**). The New Rules took effect on 4 May 2021, and all advertisements by advisers that are registered or required to be registered with the SEC are required to be in compliance by 4 November 2022.

Full details of the overhaul of the SEC advertising and solicitation rules are available in the Summer 2022 edition of the Horizon Scanner.

Further information: As the SEC releases further guidance on the interpretation of the New Rules, Dechert will provide further updates.

5.3 SEC proposes amendments to Form PF to enhance Private Fund Reporting

On 26 January 2022, the SEC proposed amendments to Form Private Fund (**Form PF**), a confidential reporting form for certain SEC-registered investment advisers to private funds. See the SEC Proposed Rule, SEC Rel. No. IA-5950 (26 January 2022) (**Release**).

As proposed, the amendments would: (1) require current reporting of certain key events for large hedge fund advisers and advisers to private equity funds, to aid in identifying fund distress or market instability; (2) reduce from

US$2 billion to US$1.5 billion the reporting threshold for large private equity advisers, and require additional reporting regarding fund strategies to enhance information accessible to the Securities and Exchange Commission (**SEC**) and Financial Stability Oversight Council (**FSOC)**; and (3) revise reporting requirements for large liquidity fund advisers to be more in line with proposed reporting requirements for money market funds in order to assess short-term financing markets. The amendments would impact large hedge fund advisers, private equity advisers and large liquidity fund advisers. The Release indicates that the amendments "*are designed to enhance FSOC's monitoring and assessment of systemic risk*" and to "*collect additional data for the [SEC]'s use in its regulatory programs.*"

Additional amendments to Form PF may be forthcoming. After the open meeting on 26 January 2022, Chair Gensler noted that he had directed the SEC Staff to work with the CFTC to consider amending the joint portions of Form PF. The public comment period on the Release closed in March 2022, and the industry anticipates a final release from the SEC in the upcoming months. For more information, see our OnPoint, available here.

5.4 SEC proposes substantial changes to Private Fund Regulatory Regime

On 9 February 2022, the SEC proposed a set of new rules and rule amendments under the Advisers Act that, if adopted, would represent the most significant changes to the regulation of private funds and their advisers since the Dodd-Frank Act. See the SEC Proposed Rules, SEC Rel. No. IA-5955 (9 February 2022). The proposed rules would:

- *Quarterly Statements:* Require private fund advisers that are registered or required to be registered with the SEC (Private Fund RIAs) to provide investors with quarterly statements that include significant detail as to the fund's performance and fees and expenses;
- *Private Fund Audits:* Require Private Fund RIAs to obtain an annual audit of each private fund, and cause the private fund's auditor to notify the SEC upon the occurrence of certain events;
- *Adviser-Led Secondaries:* In connection with adviser-led secondaries, require Private Fund RIAs to obtain a fairness opinion and distribute it to investors, along with a summary of material business relationships between the Private Fund RIA and the opinion provider;
- *Certain Other Prohibited Activities:* Prohibit all advisers to private funds (including Private Fund RIAS, exempt reporting advisers, foreign private advisers, state-registered advisers and certain other investment advisers that are not required to be SEC-registered pursuant to Section 203(b) of the Advisers Act, collectively, **Private Fund Advisers**) from engaging in certain activities (e.g., related to certain sales practices, conflicts of interest, limitations on adviser liability and indemnification, expenses charged to private funds and compensation arrangements);
- *Preferential Treatment and Restrictions on Side Letters:* Prohibit all Private Fund Advisers from engaging in certain types of differential treatment of investors (i.e., entering into side letters in respect of certain preferential redemption rights or providing preferential information where there is a reasonable expectation such treatment could have "*a material, negative effect*" on investors), while prohibiting other types of differential treatment absent disclosure to current and prospective investors;
- *RIA Annual Compliance Reports:* Require each investment adviser that is registered or required to be registered under the Advisers Act (RIA) to prepare a written report of its annual compliance program review, which the SEC intends would "*focus renewed attention on the importance of the annual compliance review process*" and assist examinations staff; and
- *Recordkeeping Amendments:* Make corresponding amendments to Advisers Act Rule 204-2 (Recordkeeping Rule) to require RIAs to make and maintain records related to certain of the newly proposed requirements.

The SEC has proposed that certain of the requirements do not apply to Private Fund RIAs that are located outside the U.S. with respect to their non-U.S. clients. However, the rule proposal was silent on the applicability of other requirements to non-U.S. advisers and their non-U.S. businesses. The industry is awaiting further guidance on these questions. The public comment period for the proposals was extended to 13 June 2022, and the industry expects that the SEC may issue final rules by the end of 2022. Once the final rules are issued, the SEC is expected to provide a one-year transition period for advisers to come into compliance with the new and amended rules.

For more information, see our OnPoint, available here.

5.5 New Short Sale Reporting Scheme

On 25 February 2022, the SEC proposed new rules under the Securities Exchange Act of 1934, which would require certain investors to file monthly reports disclosing certain short selling activity. See Rule Proposal, SEC Rel. No. 34-94313 (25 Feb 2022) available here. The public comment period for the proposal closed on 26 April 2022, and a final rule proposal may be expected later this year.

There have been no recent significant developments, and full details of the New Short Sale Reporting Scheme are available in the Summer 2022 edition of the Horizon Scanner.

5.6 Proposal to modernise beneficial ownership reporting (Schedules 13D and 13G)

On 10 February 2022, the SEC proposed rule amendments (the **Proposed Amendments**) to accelerate the filing deadlines for Schedule 13D and 13G filings, which are public reports to the SEC required for an investor who acquires beneficial ownership of more than five percent of a covered class of equity securities. See the Proposed Amendments, SEC Rel. No 33-11030 (10 February 2022). The public comment period for the Proposed Amendments has closed, and the SEC is expected to issue amendments in the upcoming months.

There have been no recent significant developments, and full details of the Proposal to Modernise Beneficial Ownership Reporting are available in the Summer 2022 edition of the Horizon Scanner.

5.7 Private fund cybersecurity requirements changing in 2022

Private funds that hold "consumer" information will face significantly stricter cybersecurity requirements under the updated Gramm-Leach-Bliley Act's Safeguards Rule adopted by the U.S. Federal Trade Commission. "Consumers" for purposes of this rule are natural persons investing primarily for personal, family or household purposes, as opposed to business or commercial purposes. The updated Safeguards Rule will require financial institutions to add more specific security controls and accountability elements to their information security programmes.

Among other things, the Safeguards Rule will now generally require multifactor authentication for any individual accessing information systems that store customer information, encryption of all customer information both in transit and during storage, and updates to record retention procedures for customer information. With respect to particular safeguards, the updated Safeguards Rule requires that they address access controls, data inventory and classification, encryption, secure development practices, authentication, information disposal procedures, change management and incident response. The updated Safeguards Rule also imposes additional obligations regarding employee training and appropriate oversight of service providers. Financial institutions that collect information from 5,000 or more consumers face additional requirements for written risk assessments, incident response plans and annual board reporting.

Financial institutions have until 9 December 2022 to comply with most of the new requirements in the updated Safeguards Rule. Private fund entities covered by the Safeguards Rule should review the changes, which may take some time to implement.

5.8 Rules to address matters related to Environmental, Social and Governance (ESG) Factors

At a meeting held on 25 May 2022, the SEC proposed requirements for investment companies and investment advisers related to environmental, social and governance (**ESG**) factors, including rules relating to fund names as well as ESG claims and related disclosures. The proposal is intended to promote the provision of "*consistent, comparable, and reliable*" information to investors to facilitate informed decision-making related to ESG investment product and strategy offerings. The proposal would require funds registered under the U.S. Investment Company Act of 1940 that consider ESG factors in their investment process to disclose additional information regarding their investment strategies in registration statements and the management discussion of fund performance section of annual reports. The SEC also proposed to amend Form ADV Part 2A to require registered investment advisers that consider ESG factors as part of their advisory business to disclose information similar to that required in fund registration statements and annual reports. The release also contains guidance related to fund and adviser compliance policies, as well as marketing materials, in the ESG context.

The public comment period for the proposal closed on 16 August 2022. For further information, see our OnPoints, available here and here.

6. HONG KONG REGULATORY INITIATIVES

6.1 Licensing requirements for Virtual Asset Fund Managers

In light of an increasing demand for virtual asset investment products, the Hong Kong Securities and Futures Commission (**SFC**) has been taking steps to clarify the legal and regulatory requirements for this market. In this regard, on 4 October 2019, the SFC issued "Proforma Terms and Conditions for Licensed Corporations, which Manage Portfolios that Invest in Virtual Assets" (**T&Cs**). The T&Cs set forth terms and conditions that are imposed on all in-scope virtual asset fund managers in the form of licensing conditions, subject to minor variations and elaborations concerning certain business models. The T&Cs are substantially similar to the SFC's Fund Managers Code of Conduct, with adaptations to the nature of virtual assets and business operations applicable to fund managers that manage virtual assets.

There have been no recent significant developments, and full details of the Licensing Requirements for Virtual Asset Fund Managers are available in the Summer 2022 edition of the Horizon Scanner.

We also discussed the T&Cs requirements in detail in our OnPoint "SFC Addresses Regulation of Managers of Virtual Asset Funds and Virtual Asset Discretionary Accounts," available here.

Dechert has successfully represented a Hong Kong-licensed fund manager in securing regulatory approval to manage portfolios that directly invest up to 100 percent in virtual (crypto) assets from the Hong Kong Securities and Futures Commission (**SFC**). This places Dechert as one of the first law firms in Hong Kong to have secured such approval for a client. Dechert has also advised that fund manager on the formation and management of its flagship virtual asset fund.

6.2 Marketing of Virtual Asset Funds

The Hong Kong financial regulators kicked off 2022 with various exciting new regulatory initiatives relating to crypto (virtual) assets. In particular, on 28 January 2022, the SFC and the Hong Kong Monetary Authority (**HKMA**) issued a joint circular to SFC-regulated intermediaries (**Intermediaries**) on their regulatory expectations for virtual asset-related activities (**VA Activities**), including distribution of virtual asset-related products (**VA-related Products**), provision of virtual asset-dealing services and provision of virtual asset advisory services (**SFC HKMA Joint Circular**). For the purposes of this publication, we will focus on the regulatory requirements in relation to distribution of VA-related Products, which is most relevant to private fund managers.

There have been no recent significant developments, and full details of Marketing of Virtual Asset Funds are available in the Summer 2022 edition of the Horizon Scanner.

Implementation Timeline*:* The full implementation of the requirements in the SFC HKMA Joint Circular has taken effect after the six-month transitional period (i.e., up to 28 July 2022) for any Intermediaries providing VA Activities (including distribution of VA-related Products).

6.3 Management and disclosure of Climate-related Risks of Fund Managers

In alignment with the Task Force on Climate-related Financial Disclosures (**TCFD**), the Fund Manager Code of Conduct (the **FMCC**) have been revised, effective from August 2022, to reflect the SFC's Consultation Conclusions on the Management and Disclosure of Climate-Related Risks by Fund Managers (the **Conclusions**). The Conclusions set out the SFC's expectations as to how fund managers should take climate-related risks into account in respect of their corporate governance, investment and risk management, and investor disclosures (the **Climate Risk Requirements**).

The Climate Risk Requirements reflect the SFC's findings – as set out in the SFC circular dated March 2019 on the Survey on Integrating Environmental, Social and Governance Factors and Climate Risks in Asset Management – that climate-related risks are a source of financial risk that need to be considered and managed by Fund Managers (as defined below).

The Climate Risk Requirements have taken effect from 20 August 2022, for Large Fund Managers (as defined below) and will take effect on 20 November 2022 for all Fund Managers.

There have been no recent significant developments, and a detailed summary of the Climate Risk Requirements can be found in the Summer 2022 edition of the Horizon Scanner.

Implementation timeline: Large Fund Managers should have complied with the Baseline Requirements by 20 August 2022, and will have to comply with the Enhanced Requirements by 20 November 2022. Fund Managers who are not Large Fund Managers will need to comply with the Baseline Requirements by 20 November 2022.

In the meantime, managers of funds that are also subject to the SFDR and the Taxonomy Regulation will need to consider whether an integrated approach to investment and risk management processes as well as disclosure will be warranted (See 1 ESG for more details of the requirements of the SFDR and Taxonomy Regulations).

****

For more information, please do not hesitate to contact a member of Dechert's financial services team, or your usual Dechert contact.

Dechert's financial services advisory capability spans 15 jurisdictions, including Ireland, Luxembourg, Germany, France and Belgium as well as throughout the United States, the Middle East and Asia. To learn more, please visit dechert.com.

Dechert
LLP

dechert.com

09-22