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Financial Services Horizon Report

2024

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Overview of the year ahead

2024 will see continued changes to the UK's and EU's financial services regulatory frameworks. The UK agenda is diverse, but founded upon the government's objectives announced in the Edinburgh Reforms of November 2022. These are (i) to create a competitive marketplace promoting effective use of capital, (ii) to ensure that the financial system acts to secure the UK as a world leader in sustainable finance, (iii) that the regulatory framework supports innovation and leadership in emerging areas of finance and (iv) ensuring that the sector is delivering for people and businesses across the UK. The agenda in the EU is broadly similar with AI, digitalisation, sustainable finance and ongoing file reviews top priority, but with differing objectives and legislative priorities, 2024 will be a year of further regulatory divergence between the UK and EU.

Please note that this document does not seek to cover all regulatory developments planned for 2024. In particular, it does not consider changes planned for the retail, insurance or pensions sectors. Equally, the timing of a number of updates remains uncertain and in some instances we are unable to identify when in 2024 they are anticipated. Furthermore, any expected date is subject to change, particularly as we approach the next general election in the UK. Equally, at the European level, 2024 will be marked by the new institutional cycle, which will start following the outcome of the elections for the Parliament in June. This will bring new decision-makers, and the arrival of new or re-elected Members of the European Parliament, changes to the Chairs of the Parliament committees and a new executive. This will be followed by the presentation of a new Commission by autumn 2024. The Council of the EU will be led consecutively by the Belgian and Hungarian presidencies.

The UK's Smarter Regulatory Framework

Reform of the UK's post-Brexit regulatory framework is progressing at a number of different levels. The Retained EU Law (Revocation and Reform) Act 2023 (the Revocation and Reform Act) received Royal Assent in July 2023. Although the final form of the "sunset" provision is more limited than initially proposed, financial services law within the scope of Schedule 1 of the Financial Servies and Markets Act 2023 had always been carved out of its application. Where the Revocation and Reform Act does impact financial services legislation, however, is in relation to its status. The Revocation and Reform Act provides that after 31 December 2023, "retained EU law" will become "assimilated law" and no longer attract the special principles of interpretation such as supremacy.

Following the UK government's consultation in 2020 on the Future Regulatory Framework, the Financial Servies and Markets Act 2023 (FSMA 2023) also received Royal Assent in July 2023. HMT has made the "significant progress" promised in relation to its work on the first tranches of the programme of reform to revoke retained EU law relating to financial services and replace it with regulator's rules. That said, much of the detail of the new framework falls to the regulators, as firm facing rules, and the bulging pipeline of regulators' initiatives reflects this.

Monitoring and adapting operationally to divergence continues to pose challenges for internationally active firms in particular, as the UK and the EU respectively and independently review various files. Firms will continue to grapple with how they approach and manage divergence during the course of 2024 and how they engage with monitoring and, where necessary, implementing change associated with the migration of assimilated EU law into the regulators' rulebooks.

UK/EU engagement

The UK and EU signed the long awaited Memorandum of Understanding on Financial Services Cooperation on 27 June 2023 and the first meeting of the EU-UK Financial Regulatory Forum was then held on 19 October. The forum discussed organisational aspects and practical arrangements for the future of regulatory cooperation, including how it could be used to exchange views on subjects including: financial stability risks; implementation of relevant international regulatory standards; regulatory developments; and the respective policies, rules and processes concerning deference regimes, such as equivalence, or other tools used to address cross-border issues. The next meeting of the forum is expected to take place in spring 2024.

Attitudes to cross-border provision of financial services

Although deference was a topic discussed at the first meeting of the EU-UK Financial Regulatory Forum, we do not anticipate any meaningful change in attitude to cross-border provision of financial services either in the EU or the UK.

EU

Concerns around the national competent authorities' handling of relocation to the EU in the context of the UK's withdrawal from the EU continue to shape regulatory reform in the EU.

The "desk mapping review", which began in May 2020, saw the ECB conduct a desk-by-desk analysis of whether the EU operations of the largest non-EU banks have appropriate internal governance and risk management capabilities for "material trading desks". The ECB indicated in a newsletter published in November 2023 that it will be ready to communicate its final decisions to the banks after assessing the comments that banks submitted during the right-to-be-heard period, which was ongoing. The decisions will likely impose requirements on banks to ensure that their material desks are aligned with supervisory expectations regarding matters like resilience and empty shells. The ECB reports that some banks already have sufficient risk management capabilities for their desks, while others still need to enhance theirs. After receiving the final decisions, banks will have up to 18 months to comply with the stated requirements. Going forward, the ECB will monitor materiality in trading activities.

The drive to harmonise treatment of third country firms providing financial services into the EU coupled with a localisation requirement is a feature of a number of current regulatory developments in the EU; CRDVI contains provisions to require third country credit institutions providing core banking services (deposit-taking, lending and issuing guarantees and commitments) to clients in a member state to establish an authorised branch in the relevant member state; EMIR 3.0 contains an obligation to maintain an active account with an EU CCP for systemically relevant products; and the EU's regulation on digital operational resilience, DORA, provides that critical ICT third-party service providers established in a third country must establish a subsidiary within the EU.

UK

On 21 December, after months of negotiation, the UK government announced that it had signed the Berne Financial Services Agreement. This agreement seeks to set sectors where the UK and Switzerland will mutually recognise each other's domestic laws and regulations on financial services, making it easier for providers to each of the two markets to do business with corporate and high net worth clients in the other. HMT describe it as "a ground-breaking pact on financial services cooperation" and previously stated that a finalised MRA between the two countries could act as a template for cross-border wholesale financial services between the UK and other countries. The agreement must be ratified by both the UK and Swiss Parliaments before it can come into force.

Following the collapse of SVB UK Limited in March 2023, the PRA suggested that it may in the future consider its current supervisory approach to UK branches of international banks but no formal consultation has been announced. Meanwhile, the November 2023 edition of the Regulatory Initiatives Grid marks HMT's review of the Overseas Persons Exclusion as "ended".

In the investment management sector, operationalising the overseas funds regime is underway. For funds in the temporary marketing permissions regime (TMPR), the FCA communicated in October that the process of exiting the TMPR and the notification of landing slots was still under review. If the Treasury makes regulations under s271A FSMA approving certain countries or territories, the FCA expects to contact fund operators shortly afterwards, with information on landing slots.

Timeline

[illegible]

– … ratings regulatory regime
▶ UK ESG

▶ UK ESG

– … with ISSB's sustainability disclosure standards
▶ UK ESG

– … on firms' ESG-related governance remuneration, incentives and training
▶ EU ESG

H1 2024
– HMT SI on Basel 3.1 implementation expected
▶ UK Prudential

H1 2024
– PRA policy reforms to geographical scope of the ring fencing regime anticipated
▶ UK ring-fencing

H1 2024
– HMT response to call for evidence on medium/long-term reforms to ring fencing regime anticipated
▶ UK ring-fencing

H1 2024
– PRA final policy on solvent exit planning for non-systemic banks and Building Societies anticipated
▶ UK Recovery and Resolution

H1 2024
– FCA to consult on changes to safeguarding requirements for payments and e-money institutions
▶ Payment services and payment systems

H1 2024 (Summer)
– FCA expects to publish policy statement and final rules regarding new UK Listing Rules Sourcebook
▶ UK Financial Markets

Summer 2024
– FCA/PRA to implement proposals on prudential assessment of acquisitions and increases in control
▶ UK Prudential

June 2024
– European Parliament elections

June 2024
– EBA amendments to the draft ITS on the draft ITS on disclosure and reporting of the minimum requirement for own funds and eligible liabilities (MREL) and the total loss absorbency requirement (TLAC) to apply
▶ UK Recovery and Resolution

June 2024
– Largest firms to publish public disclosures and the BoE to publish public statement on its assessment of the largest firms
▶ UK Recovery and Resolution

26 June 2024
– Commission to report, with legislative proposals if necessary, on IFR/IFD
▶ EU Prudential

30 June 2024
– Provisions in relation to ARTs and EMTs apply under MiCAR
▶ Fintech/Digital Assets

30 June 2024
– European Commission deadline for adopting delegated acts under Articles 134(10) and 137(3) of MiCAR
▶ Fintech/Digital Assets

30 June 2024
– Deadline for ESMA to deliver technical advice to the European Commission onfirst set of RTS and ITS under MiCAR
▶ Fintech/Digital Assets

30 June 2024
– Deadline for ESAs to issue final guidelines under Articles 21(3), 34(13) and 63(11) of MiCAR
▶ Fintech/Digital Assets

30 June 2024
– First semi-annual reference date for the EBA's ad hoc data collection of institutions' ESG data
▶ EU ESG

30 June 2024
– Second financial market participant PAI statement under SFDR Delegated Regulation deadline
▶ EU ESG

30 June 2024
– First annual TCFD disclosure reports due for UK asset managers and owners that are not excluded under the GBP5bn threshold
▶ UK ESG

End of June 2024
– Report on the FCA review into the treatment of domestic PEPs by financial services firms to be published

July 2024
– UK DBT to publish new UK Sustainability and Disclosure Standards
▶ UK ESG

July 2024
– The Transition Finance Market Review will report back to the Government
▶ UK ESG

1 July 2024
– SDDT liquidity rules apply
▶ UK Prudential

6 July 2024
– Deadline for Member States to transpose CSRD into national law and phased implementation of reporting requirements starts
▶ EU ESG

31 July 2024
– FCA consumer-focused labelling regime for investment products can begin to be used
▶ UK ESG

31 July 2024
– Consumer Duty comes into force for closed products
▶ UK Consumer Duty

31 July 2024
– Firms to present their first annual board report on Consumer Duty implementation
▶ UK Consumer Duty

2 August 2024
– European Commission to conduct an evaluation of the cross-border fund distribution framework

Mid-2024
– Round 2 of the BoE SWES scenario phase to run
▶ UK Prudential

Q3 2024
– ESMA's supervisory work on sustainability-related disclosures and the integration of sustainability risks in the investment fund sector due to end
▶ EU ESG

Q3 2024
– ESMA finalised Guidelines on Enforcement of Sustainability Information due
▶ EU ESG

Q3 2024
– Consultation on transfer of TLAC provisions from UK CRR and revision of BoE's MREL SoP
▶ UK Recovery and Resolution

Q3 2024
– FCA expects to publish policy statement on reforming commodity derivatives regime
▶ UK Financial Markets

Q3 2024
– PSR plans to extend VRPs
▶ Payment services and payment systems

Q3 2024 (Summer)
– Possible implementation date for new UK Listing Rules Sourcebook
▶ UK Financial Markets

Q3 2024 (Summer)
– FCA expects to consult on new rules for the Public Offers and Admissions to Trading Regime
▶ UK Financial Markets

September 2024
– ESMA expects to deliver to EU Commission technical advice on CSDR penalty mechanism
▶ EU Financial Market Infrastructure

2 September 2024
– EU CSDR Delegated Regulation on settlement discipline applies
▶ EU Financial Market Infrastructure

30 September 2024
– UK EMIR reporting, data quality and registration of trade repositories changes in force and new validation rules and schema apply
▶ UK Financial Market Infrastructure

30 September 2024
– One-, three- and six-month synthetic US Dollar LIBOR cessation date

H2 2024
– FCA and PRA to publish policy statements and final rules following consultations on diversity and inclusion

H2 2024
– FRC to review UK Stewardship Code
▶ UK ESG

H2 2024
– Expected deadline for PRA policy on Pillar 3 remuneration disclosures
▶ UK Prudential

H2 2024
– HMT/PRA consultation on transferring wider CRR remaining firm-facing rules into PRA Rulebook planned
▶ UK Prudential

H2 2024
– PRA to publish consultation on revised rules on capital requirements for securitisations
▶ UK Prudential

H2 2024
– BCBS plans to publish final proposal for Pillar 3 disclosure framework for climate-related financial risks
▶ Global ESG

H2 2024
– BoE expects to publish final results of SWES
▶ UK Prudential

H2 2024
– Policy statement on the alignment between ring-fencing and resolution anticipated
▶ UK ring-fencing

H2 2024
– EU Daisy Chains Directive anticipated transposition deadline
▶ EU Recovery and Resolution

H2 2024
– FCA/PRA/BoE joint consultation on incident and outsourcing and third-party reporting planned
▶ UK outsourcing and operational resilience

H2 2024
– FCA policy statement and final rules on changes to safeguarding requirements for payments and e-money institutions
▶ Payment services and payment systems

H2 2024
– ESMA to publish final report on stress testing CCPs
▶ EU Financial Market Infrastructure

H2 2024
– ESMA expected to publish register of designated publishing entities
▶ EU Financial Markets

H2 2024
– FCA expects to publish policy statement on bonds and derivatives transparency
▶ UK Financial Markets

H2 2024
– FCA and BoE to consult on rules for stablecoins
▶ Fintech/Digital Assets

By Q4 2024
– HMT expected to start a consultation on proposed amendments to the MLRs 2017

Q4 2024
– FCA expected to develop a strategy for how to address financial crime related to environmental, social, and governance (ESG) issues

Q4 2024
– ECB plans to publish a guide on governance and risk culture
▶ EU ESG

Q4 2024
– PSR final decision on remedies in relation to card scheme and processing (if required)
▶ Payment services and payment systems

Q4 2024 (October)
– Possible launch of Intermittent Trading Venue Sandbox
▶ UK Financial Market Infrastructure

October 2024
– New term of European Commission begins

7 October 2024
– Start date for PSR's reimbursement requirement policy for APP scams
▶ Payment services and payment systems

28 October 2024
– ESMA Guidelines on EMIR Refit calculation methodologies to apply
▶ EU Financial Market Infrastructure

31 October 2024
– Deadline for Group 2 PSPs to provide CoP service under PSR Special Direction 17
▶ Payment services and payment systems

31 October 2024
– ESMA due to deliver technical advice on the UCITS Eligible Assets Directive
▶ EU UCITS Directive

December 2024
– Chair of the Accelerated Settlement Taskforce to publish final report
▶ UK Accelerated Settlement

2 December 2024
– FCA naming and marketing rules for unlabelled investment products for retail investors come into force
▶ UK ESG

30 December 2024
– Recast revised WTR applies

30 December 2024
– EBA supervision guidelines on AML/CFT supervisors, extending their scope to supervisors of cryptoasset service providers apply

30 December 2024
– MiCAR remaining provisions apply
▶ Fintech/Digital Assets

30 December 2024
– Recast revised Wire Transfer Regulation applies
▶ AML/Financial Crime Fintech/Digital Assets

31 December 2024
– EU Institutions are expected to submit their first self-assessment report, under EBA guidelines on improving resolvability
▶ EU Recovery and Resolution

Q4 2024 (or Q1 2025)
– FCA expects to consult on further changes regarding public/private securitisations and the reporting regime
▶ UK Financial Markets

End of Q4
– ECB expects all banks under its supervision to be fully aligned with its expectations for climate and environmental risks
▶ EU ESG

End of 2024
– ECB expected to limit use of marketable debt instruments from high-carbon footprint entities as collateral
▶ EU ESG

End 2024/2025
– Instant Payments Regulation to apply
▶ Payment services and payment systems

1 January 2025
– Proposed implementation of the remaining Basel 3 banking standards (Basel 3.1) in the EU
▶ EU Prudential

1 January 2025
– Financial Services and Markets Act (Commodity Derivatives and Emission Allowances) Order comes into force
▶ UK Financial Markets

There are a number of developments anticipated in 2024 for which we do not have any specific indication as to timing, in particular:

HMT to publish secondary legislation for the regulation of fiat-backed stablecoins (phase 1)
▶ Fintech/Digital Assets

HMT to lay SI on near-term reforms to ring fencing regime
▶ UK ring-fencing

HMT consultation paper on SM&CR to be published

Provisions in Financial Services Act 2021 introducing the Gibraltar Authorisation Regime (GAR) likely to in force

FCA/PRA to consult on review of SMCR

Failure to prevent fraud offence under the Economic Crime and Corporate Transparency Act 2023 expected to in force

FATF to commence next round of mutual evaluation reviews (MERs)

FSB may conduct a peer review of supervisory and regulatory practices against its recommendations on climate-related risks and will consider further the state of development of macro-prudential tools
▶ Global ESG

TNFD will start tracking voluntary market adoption of recommendations for nature-related risk management and disclosure on an annual basis
▶ Global ESG

UK Government to finalise approach to the 2023 Green Finance Strategy climate resilience assessment as well as its adaptation finance deliverables and action plan
▶ UK ESG

FCA to monitor TCFD-aligned disclosures and publish findings
▶ UK ESG

FCA to consult on proposals to implement disclosure rules referencing UK-endorsed ISSB standards and the TPT framework for listed companies
▶ UK ESG

ESMA to publish report under CRR on whether ESG risks are appropriately reflected in CRA methodologies
▶ EU ESG

ESMA to publish technical standards as required under the European Green Bond Regulation and the CRAR
▶ EU ESG

ESMA to publish RTS on ESEF for taxonomy on sustainability information
▶ EU ESG

ESMA will launch a Common Supervisory Action (CSA) with NCAs on the integration of sustainability in firms'suitability assessment and product governance processes and procedures
▶ EU ESG

ESMA to publish final report to EC on greenwashing
▶ EU ESG

ESMA and NCAs to carry out Common Supervisory Action on ESG disclosures under the BMR until Q1 2025
▶ EU ESG

First annual report by ESAs on voluntary PAI disclosures to include detailed impacts under ESA-developed indicators
▶ EU ESG

ESMA to carry out preparatory work including delivery of technical standards for the ESAP
▶ EU ESG

ESAs report under CRR on impediments to availability of credit assessments by External Credit Assessment Institutions (ECAIs)
▶ EU Prudential

BCBS to consult on potential policy options aimed at reducing window-dressing behaviour by some banks in the context of the framework for G-SIBs
▶ International prudential standards

HMT to further develop the CCP Resolution regime with a set of regulations covering compensation and valuation under the regime
▶ UK Recovery and Resolution

Submission of various draft technical standards under EU DORA to European Commission
▶ EU outsourcing and operational resilience

BoE and FCA expected to confirm application process and other details for Digital Securities Sandbox
▶ UK Financial Market Infrastructure

Expected development of Intermittent Trading Venue Sandbox
▶ UK Financial Market Infrastructure

ESMA to develop guidance on internal controls for market transparency infrastructure entities
▶ EU Financial Market Infrastructure

ESMA to deliver first annual report to EU Commission on EU DLT Pilot Regime
▶ EU Financial Market Infrastructure

ESMA to develop guidelines on exemptions granted to operators of DLT market infrastructures under the EU DLT Pilot Regime
▶ EU Financial Market Infrastructure

ESMA to perform peer review for CCPs in relation to outsourcing and intragroup governance arrangements
▶ EU Financial Market Infrastructure

ESMA to revise EMIR public data requirements following EMIR Refit
▶ EU Financial Market Infrastructure

ESMA to deliver CSDR report on CSD settlement efficiency and internaliser settlement
▶ EU Financial Market Infrastructure

BCBS-IOSCO Working Group on Margin Requirements to deliver final implementation report
▶ Global Financial Market Infrastructure

FCA expects to commission study on impact of equities consolidated tape
▶ UK Financial Markets

Possible FCA consultation paper and discussion paper on transaction reporting changes
▶ UK Financial Markets

HMT expects to lay Short Selling Regulation statutory instrument
▶ UK Financial Markets

Expected FCA consultation on short selling in relation to sovereign debt and credit default swaps
▶ UK Financial Markets

Expected repeal and replacement with regulator rules of Short Selling Regulation
▶ UK Financial Markets

FCA to finalise bond consolidated tape provider tender process
▶ UK Financial Markets

Expected launch of bond consolidated tape provider selection process in EU
▶ EU Financial Markets

ESMA consultations on Level 2 and 3 changes in relation to the EU MiFID/MiFIR Review including a new consolidated tape
▶ EU Financial Markets

ESMA to select and supervise consolidated tape providers
▶ EU Financial Markets

ESMA to revise RTS on authorisation, organisational requirements and transaction publication for DRSPs
▶ EU Financial Markets

ESMA possibly to develop guidance on pre-trade control implementation by investment firms
▶ EU Financial Markets

ESMA to formalise expectations for periodic reporting for benchmark administrators, trade repositories, DRSPs and securitisation repositories
▶ EU Financial Markets

Development of phase 1 of UK transition to T+1 Settlement
▶ UK Accelerated Settlement

Progress on Investment Research Review recommendations in relation to issues other than payment optionality
▶ UK Investment Research

ESMA to continue work on pre-hedging and assisting IOSCO with global-level guidance
▶ EU Market Abuse

ESMA expected to develop guidance on impact of social media on market surveillance and market integrity
▶ EU Market Abuse

IOSCO to consider feedback on pre-hedging consultation
▶ Global Market Abuse

ESMA to revise technical standards for credit rating methodologies

UK government to respond to review and call for evidence on the Payment Services Regulations 2017
▶ Payment services and payment systems

UK government to publish a National Payments Vision
▶ Payment services and payment systems

HMT to set out approach to reforming systemic perimeter
▶ Payment services and payment systems

BoE to continue working on design phase of digital pound project
▶ Fintech/Digital Assets

Eurosystem to continue working on preparation phase of digital euro project
▶ Fintech/Digital Assets

BoE and FCA to publish details of the application process, together with guidance and rules relating to the Digital Securities Sandbox
▶ Fintech/Digital Assets

FCA to publish feedback to discussion paper and issue consultation paper on a future disclosure framework for retail investments
▶ UK PRIIPs

HMT expected to finalise and lay Consumer Composite Investments (Designated Activities) Regulations 2024 repealing and replacing existing UK PRIIPs regulatory framework
▶ UK PRIIPs

FCA to consult on PRIIPs/Consumer Composite Investments Regulation
▶ UK PRIIPs

Ongoing negotiations on possible EU PRIIPs reforms
▶ EU PRIIPs

ESMA to publish Level 2 and Level 3 materials further to AIFMD II
▶ EU AIFMD and UCITS

ESMA peer review on depositary obligations under AIFMD and UCITS expected
▶ EU AIFMD and UCITS

FCA to consult on UK AIFMD regime reform including NURS rules
▶ UK AIFMD

Cross-sector

UK Smarter Regulatory Framework

A future regulatory framework review was announced by the then Chancellor of the Exchequer at Mansion House on 20 June 2019, with the objective of reviewing the UK's financial services regulatory framework to ensure it is fit for the future. Following the UK government's consultation in 2020 on the Future Regulatory Framework, the framework for what the Treasury now calls the Smarter Regulatory Framework is contained in the Financial Services and Markets Act 2023.

HMT has made the "significant progress" promised in relation to the first tranches of the programme of reform to revoke and replace retained EU law relating to financial services. Much of the detail of the new framework falls to the regulators, as firm facing rules, and the pipeline of regulators' initiatives reflects this. Equally, there are still a number of files for the Treasury to review and the programme of reform will continue for some years.

UK Perimeter/regulated and designated activities

The Designated Activities Regime

The FSMA 2023 creates a new, parallel licensing regime under the Financial Services and Markets Act 2000 (FSMA), the Designated Activities Regime (DAR). HM Treasury has the power to make regulations providing for an activity to be a 'designated activity', if it relates to "financial markets or exchanges of the United Kingdom", or "financial instruments, financial products, or financial investments that are (or are proposed to be) issued or sold to, or by, persons in the United Kingdom". The FCA is then granted a rule-making power, which will enable it to make rules in relation to designated activities within the accountability and objectives framework for financial services regulators set by Parliament.

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

The DAR is intended to maintain the purview of the FCA over certain activities, products and conduct that are currently regulated by assimilated EU law but that are not regulated activities under the FSMA. Whilst it may at first be used to replace the assimilated EU law that is being revoked under the FSMA 2023, there is no apparent limitation to the Treasury extending it in the future to new activities or products which bring new risks (eg in relation to cryptoassets).

HMT has indicated that it anticipates a single DAR SI which, much like the Financial Services and Markets Act (Regulated Activities) Order 2001, consolidates the provisions that entities carrying out any designated activities need to be aware of. To date, however, we have seen provisions related to specific designated activities in separate draft statutory instruments such as the draft Consumer Composite Investment (Designated Activities) Regulations 2024, Financial Services and Markets Act 2000 (Public Offers and Admissions to Trading) Regulations 2023 and Securitisation Regulations 2023.

The government expects to publish the DAR SI for technical checks early in 2024 and expects it to contain a set of cross-cutting supervision and enforcement provisions that will apply to all designated activities.

Financial promotions and marketing

In December 2022, the FCA launched a consultation on 'Introducing a gateway for firms who approve financial promotions'. FSMA 2023 amended FSMA 2000 to create this regulatory gateway for all authorised firms under FSMA who wish to be able to approve financial promotions on behalf of unauthorised persons.

The government is aware that this, coupled with the strengthened rules around approving financial promotions which took effect in February 2023, is a significant change for firms, and that some firms may no longer wish to continue to approve financial promotions as a result.

The government implemented a transitional period to allow time for firms to adjust to the gateway requirements and for the FCA to determine applications for firms that do wish to carry on under the new regime. The FCA opened its window to apply for permission to approve financial promotions on 6 November 2023 and it closes on 6 February 2024. Firms that do not have permission to approve financial promotions will have to cease this activity from 7 February 2024 unless an exemption applies. The impact of these new rules on the number of firms willing and able to approve financial promotions remains to be seen.

Certain qualifying cryptoassets have also been brought into the financial promotions regime. Aside from the restrictions on those who can legally advertise cryptoasset activities, new FCA rules mean that qualifying cryptoasset financial promotions must be clear, fair and not misleading, and must include clear risk warnings and risk summaries. Firms are prohibited from offering monetary or non-monetary incentives to invest (including refer a friend or new joiner bonuses). Direct offer financial promotions (DOFPs) are subject to additional restrictions. (Please see our **blog post** for further information.)

Individual accountability

During 2023, and further to the Edinburgh Reforms announcement in December 2022, HMT published a Call for Evidence and the PRA and FCA published a Discussion Paper (DP 23/3) to build a joint evidence base for considering possible improvements to the existing Senior Managers & Certification Regime (SM&CR).

HMT's Call for Evidence was deliberately broad in scope, asking whether SM&CR had effectively delivered its objectives and whether those objectives remain relevant and correct for the UK. DP 23/3 was similarly wide-ranging, asking for views on the effectiveness, scope and proportionality of SM&CR. No feedback to the papers has been published yet, but the regulators confirmed in their Regulatory Initiatives Grid in November 2023 that in 2024 there will be further formal engagement and a consultation paper in Q2. Please also see the D&I section below which covers current PRA and FCA proposals to update aspects of the SM&CR regime in relation to diversity and inclusion.

In addition to the possible reforms to the existing SM&CR regime (as described above), FSMA 2023 creates a framework for SM&CR for FMIs (please see the Financial markets section below for additional commentary on this).

In 2021, the regulators mooted extending SM&CR to payment and e-money firms but there has been no specific movement on this, although HMT did confirm in August 2023 that the government would set out the next steps regarding future consultations on this once the broader SM&CR review has finished.

There have also been developments relevant to individual accountability on the EU front as part of the EU's proposed implementation of Basel 3.1, by way of the European Commission's Banking Package 2021. These include a set of "fit-and-proper" rules to ensure senior staff have the requisite skills and knowledge for managing a bank. The main topics covered by the new rules are: (i) checks which must be carried out (usually) before managers and "key function holders" take up their senior role; (ii) powers for supervisors; (iii) standardised process and information requirements for verifying senior staff; (iv) measures to ensure cooperation between the bank and its supervisor in assessing suitability; (v) certain AML suitability requirements which would be applied to managers and key function holders; and (vi) the promotion of diversity in the composition of banks' management bodies. Please see the Banks and bank regulation section below for more on the European Commission's Banking Package 2021.

D&I

D&I issues have been in the spotlight throughout 2023 and this will remain the case in 2024.

The key regulatory developments for 2024 are the PRA and FCA consultations on diversity and inclusion in the financial sector (CP 18/23 and CP 23/30). The regulators deliberately synchronised their proposals where appropriate, and the proposals apply differently depending on the type, size and nature of the firm (including how SM&CR applies). As a high-level summary, the proposed changes relate to (i) D&I strategies; (ii) D&I targets; (iii) senior management functions; (iv) fitness and propriety and conduct rules; (v) regulatory reporting; and (vi) disclosure.

The regulators intend to publish policy statements and final rules in H2 2024, with the final rules coming into force 12 months thereafter.

Additionally in 2024, the House of Commons Treasury Select Committee will continue its "Sexism in the City" enquiry, which was launched in July 2023. The enquiry is currently gathering oral and written evidence on relevant topics, including issues in relation to gender pay gaps, sexual harassment and misogyny.

Sustainability and ESG

Please also see the Cross-sector section for commentary on D&I developments for 2024.

Disclosure and reporting

A key development for 2024 is that the new regime under the Corporate Sustainability Reporting Directive (CSRD) will start to apply in stages. Member States are required to transpose the CSRD into national legislation by 6 July 2024, and a phased application will commence from 1 January 2025. The new CSRD regime will impose enhanced ESG-related disclosure and reporting requirements on companies, and extend the application of the Non-Financial Reporting Directive (NFRD) to more companies. It will also introduce more detailed reporting requirements, and will require adherence to mandatory EU sustainability reporting standards.

A specific CSRD development is ESMA's consultation on guidelines on the supervision of sustainability reporting by national competent authorities, to promote convergent supervision of sustainability reporting. The CSRD amends the Transparency Directive so as to mandate ESMA to issue guidelines on the supervision of sustainability reporting by national competent authorities, and, in December 2023, ESMA accordingly published its consultation on draft Guidelines on Enforcement of Sustainability Information (GLESI). The consultation ends on 15 March 2024, with final guidelines due in Q3 2024.

The other significant development in this quarter is recent progress on the proposal for a directive on Corporate Sustainability Due Diligence (CSDDD). This would introduce a due diligence duty on large EU companies and non-EU companies with significant EU activity, in respect of actual or potential adverse human rights and environmental impacts in their operations, subsidiaries and value chains. The proposal was originally made by the Commission in February 2022, and in December 2023 it was confirmed that the European Council and European Parliament had reached a provisional deal. The next steps will be for each body to endorse and formally adopt the provisional agreement.

Taxonomy

The Taxonomy Regulation is a key plank of the EU's overall sustainable finance strategy, and one of many novel initiatives the EU has introduced. In general terms, it is intended to create a shared understanding of what activities can be considered "green" or environmentally sustainable. It also requires certain businesses and firms to make statements about whether and to what extent their activities (or in some cases, products) align with the taxonomy. 2024 will see some Level 2 and Level 3 developments in relation to the Regulation.

In November 2023, two delegated acts under the Taxonomy Regulation were published in the EU Official Journal, with effect (in the main) from 1 January 2024. The first amends the Climate Delegated Act and the key update is adding new screening criteria for economic activities that contribute to climate-related objectives. The second establishes new screening criteria for economic activities that contribute to non-climate related objectives, adding extensive technical screening criteria for use in determining whether an economic activity qualifies as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution prevention and control, or to the protection and restoration of biodiversity and ecosystems, and for determining whether that economic activity causes no significant harm to any of the other environmental objectives prescribed under the taxonomy. It also amends the Disclosures Delegated Act to make certain clarifications.

Additionally, in December 2023 the Commission published a set of FAQs in relation to Taxonomy Regulation topics which are expected to be formally adopted in 2024 as soon as the different language versions are available. Topics covered include the scope of requirements, reporting requirements and how to deal with specific types of exposures.

Please also see SFDR section below which notes the current ESMA CSA which is relevant to the Taxonomy Regulation.

SFDR and labelling

There were a number of key developments in relation to the EU SFDR framework in Q4 2023 which are expected to lead to further updates in 2024.

In Q4 2023, the Commission consulted on the implementation of SFDR to collect feedback on the strengths and weaknesses of the regime, and views as to how it may evolve going forward, including the possible introduction of a product labelling regime. The consultation closed on 15 December 2023, and the Commission is believed to be proposing to publish a report in Q2 2024 (although this timing is tight).

In parallel, in December 2023, the ESAs published their final report on aspects of the operation of the SFDR Delegated Regulation including disclosures of principal adverse impacts (PAI) of investment decisions on sustainability factors and the introduction of disclosure requirements around decarbonisation targets. Specifically, the report covers various topics including (i) extension of social PAI indicators; (ii) other changes to the PAI disclosure framework; (iii) disclosure of greenhouse gas emission reduction targets; (iv) improvements to product templates; and (v) certain other minor technical amendments. In terms of next steps for 2024, the Commission will review the report and then, if endorsed, the proposals will proceed to be reviewed and approved by the European Parliament and Council (but no specific timings or dates have been confirmed yet).

Also on PAI matters, in 2024, the ESAs will publish their annual report on the extent of voluntary PAI disclosures under SFDR. The ESMA 2024 work programme notes that this will be the first annual report to consider statements published in the SFDR Delegated Regulation including detailed impacts under the indicators developed by the ESAs, and that the ESAs may also decide to provide further technical standards or guidance, for example in relation to marketing documents or other additional empowerments that may be generated by the Commission's review of SFDR (as described above).

Currently, ESMA is running a Common Supervisory Action, which was launched in July 2023, on sustainability-related disclosures and the integration of sustainability risks. This is likely to run until Q3 2024. Among other things, the goal is to assess the compliance of firms with SFDR and the Taxonomy Regulation, as well as the provisions in the UCITS and AIFMD regimes on the integration of sustainability risks. The exercise will also consider greenwashing risks in the investment management sector, and whether additional regulatory intervention is required.

Additionally, ESMA confirmed a delay to the publication of final guidelines on the use of ESG-related terms in fund names in December 2023. This delay is in order to accommodate other work being done on AIFMD and the UCITS Directive. The timing for the publication of the final guidelines is therefore now unclear but this could potentially be in Q2 2024 on the basis that the changes to AIFMD and the UCITS Directive may be finalised in Q1/Q2 2024.

Greenwashing risks and issues

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

In November 2022, the ESAs expressed their commitment to preventing greenwashing, by launching a call for evidence looking to understand the key features, drivers and risks associated with greenwashing. The ESAs published a progress report on their work in May 2023, with the final report due in May 2024. This will provide a stock take of relevant supervisory powers, resources and actions to address greenwashing risks, and is also expected to propose recommendations and remediation actions.

In December 2023, ESMA announced the launch of a Common Supervisory Action or CSA with national competent authorities on ESG disclosures under the Benchmarks Regulation (BMR). The CSA will focus on supervised benchmarks administrators that have acquired an authorisation, registration, recognition or endorsement of their benchmarks under the BMR. The goal is to assess compliance with the ESG disclosure requirements in the BMR. The CSA will be carried out during 2024 and until Q1 2025.

ESG ratings

In June 2023, the Commission published its proposal for ESG ratings providers to be supervised by ESMA, with a view to improving the reliability, comparability and transparency of ESG ratings and the quality of information about ESG ratings. The aim of these improvements is to enable investors and rated entities to take better informed investment and risk management decisions about sustainability and ESG objectives and risks. In December 2023, the Council and Parliament confirmed their positions and the proposed new regulation, and trilogue negotiations are expected to commence in Q1 2024.

New EU Green Bond Regime

The EU's new Green Bond Regulation was published in the EU's Official Journal in November 2023. It will come into force 20 days from the day of publication with application from 21 December 2024.

The regime introduces the European Green Bond label as a designation which can be used on a voluntary basis by bond issuers. Issuers seeking to use the label will need to: (i) comply with the allocation requirements; (ii) provide pre- and post-issuance disclosure; (iii) have that disclosure externally reviewed; and (iv) be willing to submit to the oversight of the competent authority of their home Member State under the EU Prospectus Regulation. An issuer does have alternatives. It has the option under the Regulation to provide sustainability disclosures for: (i) use-of-proceeds bonds not using the label but marketed as environmentally sustainable; or (ii) sustainability-linked bonds, although competent authority supervision will still apply in this case. Importantly, an issuer will also still be able to continue to follow the ICMA Principles instead, should it prefer. The regime also establishes a system to register and supervise external reviewers of European Green Bonds. ESMA is now preparing for the delivery of technical standards under the regulation.

Other initiatives

In September 2023, ESMA and the EBA published their 2024 work programmes, both of which confirmed ESG priorities.

Key 2024 objectives for ESMA are:

- Continue the work in its Sustainable Finance Roadmap 2022-24 – eg (i) analysing the drivers of greenwashing and developing instruments and tools to enable national supervisors to best address this risk; (ii) building capacity through the training of national supervisors and/or the development of a knowledge hub and supervisory guidance; and (iii) developing monitoring indicators on ESG markets and products and integrating environmental risks in stress-testing frameworks, in collaboration with others (eg the other ESAs);
- Contribute to facilitating the financing of the EU transition towards a more sustainable economy, while preserving market integrity and financial stability as well as a high level of investor protection;
- Promote the effective and consistent integration of sustainability-related factors in supervisory, convergence, risk assessment and regulatory activities;
- Maintain investor confidence in ESG investments by promoting high-quality sustainability disclosures and hence reduce the risk of greenwashing; and
- Systematically monitor ESG market developments and climate risk.

Two particular items of work ESMA will deliver in 2024 are the final report on greenwashing (as mentioned above, and expected in May 2024), and the technical standards for the European Single Access Point (ESAP). ESMA will also continue preparatory work on the necessary IT infrastructure which will support ESAP.

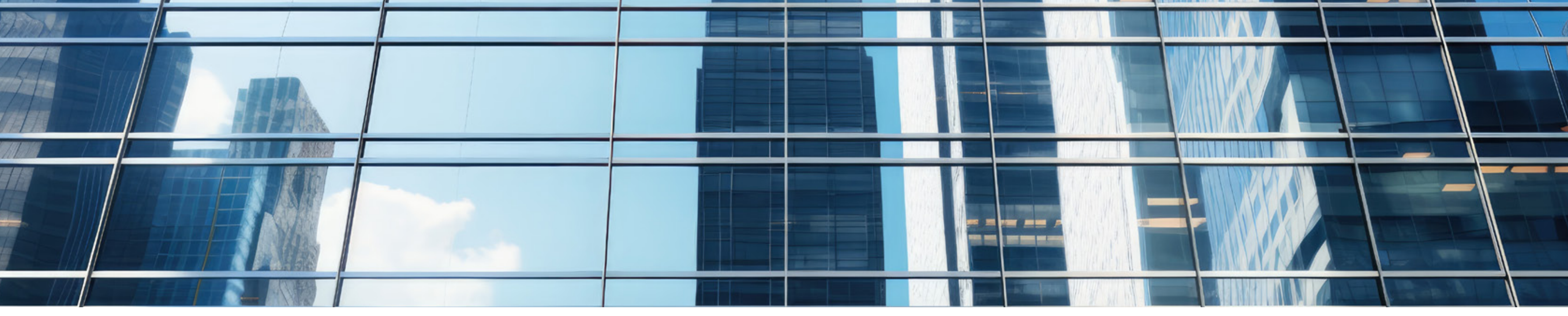
The EBA's 2024 work programme confirmed its strategic priority to foster stability in a sustainable economy. A number of items are ongoing actions from the EBA's December 2022 sustainable finance roadmap – for example, the EBA will continue building its ESG risk monitoring framework to be able to monitor ESG risks in the banking sector.

Prudential

Strengthening the resilience of the banking sector to environmental, social and governance (ESG) risks is a key area of the Commission's Sustainable Finance Strategy. The European Commission's Banking Package 2021 contained proposals aimed at improving the way banks measure and manage these risks, and to ensure that markets can monitor what banks are doing. The texts of CRRIII and CRDVI were politically agreed in December 2023 and submitted to the European Parliament and the Council for final vote.

The co-legislators have strengthened the provisions related to ESG risks, as proposed by the Commission, on a number of aspects such as: (i) requiring banks to draw up transition plans that will need to be consistent with the sustainability commitments banks undertake under other pieces of EU law, such as the CSRD; (ii) supervisors are to oversee how banks handle ESG risks and include ESG considerations in the context of the annual supervisory examination review (SREP); (iii) ESG reporting and disclosure requirements for all EU banks, with proportionality for smaller banks; and (iv) permitting a favourable risk weight treatment only where the relevant bank finances an infrastructure project that has a positive or neutral environmental impact assessment. Credit institutions will require robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of ESG risks over an appropriate set of time horizons. The EBA is also mandated to produce guidelines on the criteria for the assessment of ESG risks, including how they should be identified, measured, managed and monitored as well as how credit institutions should draw concrete plans to address and internally stress test resilience and long-term negative impacts to the ESG risks.

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



Disclosure and reporting

In June 2023, the International Sustainability Standards Board (ISSB) launched its first sustainability-related reporting standards: the General Requirements for Disclosure of Sustainability-related financial information (IFRS S1), and the requirements for Climate-related Disclosures (IFRS S2). The UK government is now considering these for endorsement, with the decision to be made by the Secretary of State for the Department for Business and Trade. The overall process is supported by two committees established for this purpose: the UK Sustainability Disclosure Technical Advisory Committee (TAC) (supported by the Financial Reporting Council) and the UK Sustainability Disclosure Policy and Implementation Committee (PIC) (supported by the UK Department for Business and Trade).

The ultimate goal is to create UK Sustainability Disclosure Standards (SDS) to form the basis of future requirements in UK legislation or regulation for companies to report on ESG related risks and opportunities. The new UK standards are due to be published by the UK Department for Business and Trade by July 2024, and to be based on the IFRS standards referred to above.

The FCA has said that, once these are available for use in the UK, its intention is to update its climate-related disclosure rules to reference the IFRS standards; eg its current TCFD-aligned disclosure rules for listed companies. The FCA has suggested a consultation for this purpose in H1 2024. The FCA's stated aim is to finalise its policy position by the end of 2024, with a view to bringing new requirements into force for accounting periods beginning on or after 1 January 2025. The first reporting would begin from 2026.

The FCA has said it also expects to consult on moving from the current "comply or explain" compliance basis to mandatory disclosures for listed issuers.

The FCA is also due to consult on guidance to set out its expectations for listed companies' transition plan disclosures. This is likely to reflect the finalised Disclosure Framework and supporting guidance published by the UK Transition Plan Taskforce (TPT) in October 2023, to help private sector companies develop, disclose, and deliver "gold standard" climate transition plans.

The FCA consultation in 2024 is therefore likely to concern a draft set of rules and guidance for listed companies to disclose in line with the new standards, with the TPT framework as a "complementary package".

In parallel, the FCA has said it will continue to use thematic reviews in 2024 to consider disclosures within the scope of the existing disclosure regime, and to continue to evolve its supervisory approach (with more information to be provided on this as part of the consultation referred to above).

Taxonomy

In March 2023, the UK issued its 2023 Green Finance Strategy, which (among other things) promised a consultation on the proposed UK Green Taxonomy in autumn 2023, but this has been delayed. Currently the HMT consultation on the UK Green Taxonomy is expected in H1 2024.

The 2023 Green Finance Strategy also indicated that the UK government would introduce a testing period of voluntary disclosures for at least two reporting years before the introduction of mandatory obligations.

SDR and labelling regime

On 28 November 2023, the FCA issued its final policy statement on the first stage of the roll-out of the UK Sustainability Disclosure Requirements (SDR), as well as the FCA's long awaited new ESG labelling regime for funds.

The labelling regime will require firms to consider if they wish to use the label or not, with any new or existing funds. If a label is used, prescribed criteria must be met. This is highly onerous.

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

The new regime comes into effect in phases, for example, firms are permitted to begin to use the new labels from 31 July 2024, with the naming and marketing rules coming into effect from 2 December 2024.

Alongside these initiatives, the FCA has announced it is setting up an independent working group for the financial advice industry to work with the FCA "to build on existing capabilities in sustainable finance, including how the SDR and labels regime supports their role".

Greenwashing risks and issues

The FCA's November 2023 policy statement on SDR (see above) introduced a new anti-greenwashing rule that will apply to all regulated firms. Broadly speaking, a relevant firm must ensure that any reference to the sustainability characteristics of a product or service is consistent with the sustainability characteristics of the product or service, and is fair, clear and not misleading. This will apply to all communications with clients in the UK in relation to a product or service, or communications of a financial promotion or approval of a financial promotion for communication to a person in the UK. The rule will apply from 31 May 2024.

The FCA has also issued a guidance consultation that sets out its expectations for firms making claims about the sustainability of a product or service, which closes on 26 January 2024. The FCA proposes to publish final guidance which will come into force on 31 May 2024.

Also in November 2023, the FCA issued findings from its supervisory work looking at how UK fund managers comply with existing regulatory requirements in relation to ESG and sustainable funds. This followed a Dear Chair letter, issued in July 2021, expressing concerns about industry standards as regards funds whose strategies focus on ESG themes, and providing a set of guiding principles to clarify expectations. The FCA is expected to carry forward the points raised in its findings over the next 12-24 months.

At a global level, in December 2023, the International Organization of Securities Commissions (IOSCO) published a report on Supervisory Practices to Address Greenwashing. This followed its call for action on 7 November 2022, calling on voluntary standard setting bodies and industry associations to promote good practices among members to counter the risk of greenwashing related to asset managers and ESG rating and data providers.

ESG ratings

In Q1 2023, the UK government consulted on a proposal to require ESG ratings providers to be subject to authorisation in the UK going forward. It has stated that these services are increasingly a component of investment decisions, and the government wants to ensure improved transparency and good market standards. The consultation closed on 30 June 2023 and the government is expected to publish feedback to the consultation in H1 2024.

In the interim, the ESG Data and Ratings Code of Conduct Working Group has concluded its work on a code of conduct applicable to both ESG ratings and data providers on a voluntary basis. The final version was issued in December 2023.

These initiatives may have significant knock-on impacts for financial services firms generally, given the increased commercial pressure from investors and the market for ESG data and for issuers and/or financial instruments to be the subject of ESG ratings or scores. Among other things, this enables investors and the market to assess how ESG-friendly a financial instrument, issuer or firm may be. It may also assist investors in incorporating ESG risk into their investment decision making process, which is an increasing trend and the preferred approach from a regulatory perspective.

Net zero targets

The UK Government has expressed an ambition for the UK to be "the first ever Net Zero Aligned Financial Centre" and "the best place in the world for green finance". To this end, in March 2023, the government issued the 2023 Green Finance Strategy, containing a number of initiatives and detailed timings. However, the response has not been universally positive. The Committee on Climate Change is an independent statutory body established under the Climate Change Act 2008 to advise the UK government on emissions targets and report to Parliament on progress. It considers that "progress is off-track in a number of areas" for the UK and has criticised the UK government for sending "confusing signals on its climate priorities to the global community". The confidence of the committee in terms of the UK hitting its legally prescribed carbon reduction targets "is now markedly less than it was in our previous assessment a year ago".

With this in mind, the UK government may be under pressure to publish more ambitious initiatives over the next 12-24 months, with the aim of getting back on track.

The UK government has commissioned a review into how the UK can become "the best place in the world for raising transition capital" (the Transition Finance Market Review), focusing in particular on "what the UK financial and professional services ecosystem needs to do to become a leading hub for and provider of transition financial services – by facilitating UK and international companies and investors to invest to align with credible net zero pathways". The government has defined 'transition finance' as financial products and services that support higher emitting companies and activities to decarbonise over time. The review is expected to result in a report issued in July 2024.

Other initiatives

In February 2023, the FCA published a broad-ranging discussion paper to begin stakeholder engagement on ESG governance, remuneration, incentives and training in regulated firms. The FCA has indicated that it plans to publish a feedback statement in H1 2024.

The FCA is continuing its work on stewardship, as the upgraded UK Stewardship Code continues to bed down. The deadline for applications for the next round of applicants is in April 2024. The UK government's 2023 Green Finance Strategy flagged several initiatives on stewardship set to continue in 2024. This includes work the UK government indicated it wished to conduct, with the FCA, the Financial Reporting Council and the Pensions Regulator, to review the regulatory framework for effective stewardship in relation to climate and environmental oversight, including the operation of the Stewardship Code. The UK government has promised that, ahead of this review, it will begin to engage with stakeholders and seek evidence, but the timing for this is not clear. It has also foreshadowed that, depending on the evidence it receives and the outcome of the review, it may take further action to "ensure the effectiveness of the stewardship regulatory framework".

In parallel, the UK government is conducting various work in relation to pension trustees; eg the UK Department for Work and Pensions is considering the extent to which its Stewardship Guidance, introduced in 2022, is being complied with. This is to be complemented by a working group of the Financial Markets and Law Committee to consider the issues around fiduciary duty for pension trustees in the context of net zero and whether further action is needed. The government will also hold a series of roundtables to engage with interested stakeholders on how it can continue to clarify the fiduciary duty issue.

Prudential

In March 2023, the Bank of England published a report on climate-related risks and the regulatory capital frameworks. This report builds upon a 2021 Climate Change Adaptation Report and notes potential regime gaps to capture systemic risks from climate change and unintended consequences. The Bank has identified a number of next steps including: (i) ensuring that firms make progress to address capability gaps to improve the identification, measurement, and management of climate risks; (ii) developing its capabilities to test the resilience of the financial system to climate risks; and (iii) progressing work to understand material regime gaps in the capital frameworks. The Bank will consider the potential systemic risks of climate change and explore whether any changes to the macroprudential framework might be appropriate. The Bank continues its business-as-usual supervision against firms' progress at embedding supervisory expectations in these areas as set out in SS3/19. This will also involve work to build an understanding of banks' evolving approaches to Pillar 2A capital add-ons through an ongoing supervisory review and evaluation process. It will also consider whether further guidance or updates to the expectations set out in SS3/19 are warranted over time.

Alongside this, the Bank will continue to engage in relevant discussions at international fora on how regulatory frameworks and supervisory practices need to be adjusted to account for climate risks.

Banks and bank regulation

Prudential

International standards

Although the BCBS had set 1 January 2023 as the implementation date for the final Basel III (Basel 3.1) reforms, they remain outstanding in most jurisdictions. The EU's measures to implement are anticipated to come into force on 1 January 2025 and the PRA announced in September that the UK's implementation date would be deferred to 1 July 2025 (matching the US implementation date).

The PRA's near-final policy in respect of market risk, credit valuation adjustment risk, counterparty credit risk and operational risk was published in December 2023. Near-final policies on the remaining elements of Basel 3, in particular credit risk, credit risk mitigation, the output floor, and reporting and disclosure requirements are anticipated in Q2 2024. HMT's SI to revoke the relevant articles of UK CRR and to construct the relevant legislative framework to effect the implementation is also expected be laid in H1 2024. UK firms affected by the Basel 3.1 amendments will be monitoring the development of the PRA's policies and considering their impacts and any pre-application requirements which may need to be taken during the course of 2024.

In November 2023, the BCBS published technical amendments relating to the standardised approach to operational risk, the disclosure standards for credit valuation adjustment risk, calculating the score for the trading volume indicator in the G-SIB framework and related disclosure requirements, the inclusion of insurance subsidiaries in the disclosure of the leverage ratio exposure measure in the G-SIB framework and the impact of the new market risk framework on the countercyclical capital buffer (CCyB). The BCBS expects these amendments to be implemented within three years and they may find their way into policy proposals in the UK and the EU during 2024 and beyond.

EU Banking Package 2021/CRDVI

The EU's proposed implementation of Basel 3.1 policy is contained in the European Commission's Banking Package 2021, which proposes numerous further amendments to the Capital Requirements Regulation (CRR3) and Capital Requirements Directive (CRDVI). Political agreement was announced on 28 June 2023, and in December, the preparatory bodies of the Council and Parliament endorsed the package and published the legal texts. Although still subject to legal revision and to the final vote in the Plenary, the texts are intended to provide transparency and to allow banks to prepare for the final phase of their implementation of the Basel III agreement in the Union. Publication in the Official Journal is anticipated in Spring 2024. The EBA is starting its consultation on key technical standards as detailed in its roadmap on Basel III implementation.

The package contains policy proposals beyond Basel 3.1 implementation. These include ESG prudential requirements, discussed above, and proposals to provide stronger tools for supervisors overseeing EU banks. In particular: (i) a clear, robust and balanced "fit-and-proper" set of rules, where supervisors assess whether senior staff have the requisite skills and knowledge for managing a bank; (ii) better tools to oversee fintech groups, including bank subsidiaries; and (iii) proposals seeking to harmonise the authorisation and supervision of third country banks and systemic investment firms.

Please see our **bulletin** for further information on the third country entity proposals.

Prudential regimes for cryptoasset exposures

The BCBS has also published standards on the prudential treatment of cryptoasset exposures which it expects its members to implement by 1 January 2025. The standards divide cryptoassets into two groups. Tokenised traditional assets and stablecoins with effective stabilisation mechanisms that meet classification conditions will attract the same own funds requirements as their reserve assets or the assets they refer to, with the possibility for supervisors to impose add-ons. The second group, which comprises the riskiest forms of cryptoassets, are to be risk-weighted at 1,250%. Holding limits will also apply to this second group of assets.

The BCBS published a consultation on disclosure requirements related to banks' cryptoasset exposures in October 2023 and a consultation on targeted adjustment to its standard on banks' exposures to cryptoassets in December 2023.

The proposals expand the criteria on the composition of the reserve assets that back stablecoins, covering issues such as the credit quality, maturity and liquidity of the reserve assets. The requirements determine whether the stablecoins to which banks may be exposed will be eligible for inclusion in the Group 1b category of cryptoassets, and thus benefit from a preferential regulatory treatment.

Under the proposals, banks would also be required to perform due diligence to ensure that they have an adequate understanding of the stabilisation mechanisms of stablecoins to which they are exposed, and the effectiveness of those mechanisms. As part of the due diligence performed, banks would be required to conduct statistical or other tests demonstrating that the stablecoin maintains a stable relationship in comparison to the reference asset.

The BCBS proposes a standardised disclosure table and set of templates for banks' cryptoasset exposures. Firms with cryptoasset exposures should monitor applicable legislative developments and their relevant prudential regulator's publications for its proposals to implement these standards.

In the EU, CRR3 requires the Commission to submit a legislative proposal by 30 June 2025 to implement the BCBS standard and to specify the prudential treatment applicable to banks' cryptoasset exposures in the transitional period until the implementation. That transitional treatment is required to take into account the legal framework introduced by MiCAR.

During the transitional period, tokenised traditional assets, including e-money tokens, should be recognised as entailing similar risks to traditional assets and cryptoassets compliant with MiCAR, and referencing traditional assets other than a single fiat currency should benefit from a capital treatment consistent with the requirements of MiCAR. Exposures to other cryptoassets, including tokenised derivatives on cryptoassets different from the ones that qualify for the more favourable capital treatment, should be assigned a 1,250% risk weight.

The ECB has concerns about the possibility of circumventing the regulatory framework. In particular, the fact that if cryptoasset service providers controlled by banks are not within the scope of their prudential consolidation, the BCBS standard and especially the exposure limit may become ineffective. The ECB urges that including CASPs in the scope of prudential consolidation of banking groups by modifying the definition of financial institution needs to be considered as a matter of urgency.

In addition to the treatment of cryptoasset exposures, draft technical standards published in November 2023 under MiCAR prescribe various aspects of prudential requirements for issuers of asset-referenced tokens (ARTs) and e-money tokens (EMTs) including in relation to the requirement to adjust own funds requirements, stress testing, the minimum contents of liquidity management policies and procedures and the liquidity requirements of the reserve of assets. Please see our **blog** for further information.

In the UK, in 2022, the PRA published a Dear CEO letter which, pending the outcome of international regulatory updates, sought to highlight aspects of the existing framework that the PRA would expect firms to consider when measuring and mitigating risks resulting from crypto activities. While no one part of the current framework fully captures crypto risks, the PRA indicated that a combination of strong risk controls, operational risk assessments, robust new product approval processes, Pillar 1, Pillar 2, and ongoing monitoring arrangements has the potential to provide firms with an appropriate interim treatment.

Climate-related financial risks

Work in relation to climate-related financial risks also remains a priority for the Basel Committee and is a key theme of its 2023-24 work programme.

In late November 2023, the BCBS began consulting on a Pillar 3 disclosure framework for climate-related financial risks. The BCBS recognises that the accuracy, consistency and quality of climate-related data is still evolving, but at the same time, disclosure requirements will accelerate the availability of such information and facilitate forward-looking risk assessments by banks. For each area under consideration, the BCBS has included draft disclosure tables and templates for illustrative purposes and to solicit stakeholder feedback on the meaningfulness and comparability of potential future disclosures. The deadline for comments is 29 February 2024. The BCBS intends to publish a final proposal in H2 2024 and is considering a potential implementation date of 1 January 2026.

The EU's CRDVI and CRRIII contain new prudential requirements relating to ESG risks for EU banks, and the Bank of England is committed to undertaking further work on these topics, as outlined in a report published in 2023, as discussed in our sustainability section above.

EU IFR/IFD

The EBA and ESMA are asked to deliver their joint report to the commission on the prudential framework for investment firms that has applied since June 2021, by 31 May 2024. The Commission is then to report, with legislative proposals if necessary, by 26 June. The report should cover topics including: the conditions for investment firms to qualify as small and non-interconnected firms; the modification of the definition of credit institution in the CRR to include systemically important investment firms; the framework for equivalence in financial services; the Article 1(2) conditions for investment firms to apply the requirements of the CRR; the provisions on remuneration in the IFD and the IFR as well as in the AIFMD and the UCITS Directive, with the aim of achieving a level playing field for all EU investment firms and the cooperation of the EU and member states with third countries in the application of the IFD and IFR.

Although the EU's prudential regime for investment firms has been in place since 2021, for significant EU investment firms Regulatory Technical Standards on the reclassification of investment firms as credit institutions in accordance with Article 8a (6)(b) of Directive 2013/36/EU remain outstanding. The IFD amended the Capital Requirements Directive (CRD) by introducing Article 8a regarding specific requirements for the authorisation of significant investment firms as credit institutions. The EBA was mandated to develop draft RTS to specify the methodology for calculating the thresholds referred to in paragraph 1 of Article 8a of the CRD. It published its final report and draft RTS in December 2021, but the draft RTS included a group asset test which the EBA described as "neutral with regards to geographical limitations". This approach caused concern, particularly amongst third country groups. CRDVI will amend Article 8a to clarify that the threshold applies to all "undertakings in the group established in the EU, including any of its branches and subsidiaries established in a third country".

Meanwhile, the EBA advised competent authorities in July 2021 to apply a pragmatic approach for those investment firms where the relevant EUR 30bn threshold for the identification of the prudential regime to be applied to the investment firm cannot be determined without the guidance provided in the EBA RTS. More specifically, the EBA advised supervisors not to prioritise any supervisory or enforcement action in relation to the identification of investments firms until six months after the final methodology is in place.

The EBA's work programme for 2024 highlights that it intends to publish guidelines on the application of the group capital test in Q1 2024 and a report on the application of gender neutral remuneration policies under Article 26(4) of the IFD in Q2 2024.

UK IFPR

The FCA carried out a multi-firm review in 2023 to assess the progress of firms in adopting the new regulatory regime for MiFID investment firms, including the conduct of their ICARA processes. This focused on capital adequacy, liquidity adequacy and wind-down planning under the ICARA process. The FCA also took account of how firms were reporting under MiFIDPRU. The FCA has identified a number of areas for improvement and is following up with firms that participated through its usual supervisory activities. The FCA encourages firms to continue to develop their ICARA process to adopt practices which improve on those contained in the review findings.

Maintained observation of ‘shadow banking’

A key area of policy focus for the FSB in 2024 is addressing financial stability risks from non-bank financial institutions (NBFI) leverage. It published a progress report on its work ‘Enhancing the Resilience of Non-Bank Financial Intermediation’ in September 2023 which details planned initiatives. Deliverables for 2024 include stand-alone reports in specific areas of the programme and an overall progress report to the G20 in late 2024.

In the EU, the Delegated Regulation supplementing the CRR with regard to regulatory technical standards specifying the criteria for the identification of shadow banking entities entered into force on 1 January 2024. Under the CRR, credit institutions are required to report their largest exposures to shadow banking entities on a consolidated basis. The RTS specify: (i) the criteria for identifying both shadow banking and non-shadow banking entities; (ii) the definition of banking activities and services; and (iii) the criteria for excluding entities established in third countries from being deemed as shadow banking entities. The RTS are aligned with the guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under the CRR.

In the UK, the Bank of England launched its first system-wide exploratory scenario (SWES) exercise on 19 June 2023. The SWES aims to: (i) enhance understanding of the risks to and from NBFIs, and the behaviour of NBFIs and banks in stress; and (ii) investigate how these behaviours and market dynamics can amplify shocks in markets and potentially bring about risks to UK financial stability. A final report will be published in 2024 which will include the system-wide findings, implications for the SWES markets of focus, and any conclusions for the Bank of England’s assessment of risks to UK financial stability. The SWES is not a test of the resilience of the individual firms participating.

On 10 November, bank and non-bank SWES participants were provided a hypothetical severe, but plausible stress scenario. The severity of the aggregate shocks included in the scenario is faster, wider ranging and more persistent than observed both in the September/October 2022 liability-driven investment and the March 2020 dash-for-cash episodes. Participants will submit their responses in January 2024. The Bank of England intends to run a second round of the scenario phase through 2024 and to publish a final report on the SWES by end 2024.

Additionally, in the UK, the PRA is currently consulting on the identification and management of step-in risk, shadow banking entities and groups of connected clients. The PRA has set out proposed rules requiring CRR firms that are not small domestic deposit takers (SDDTs, see below) and CRR consolidation entities that are not SDDT consolidation entities, to regularly assess their step-in risk. The proposals would require firms to develop their own step-in risk policies and procedures and to report their assessment. These proposals build on the BCBS’ guidelines on the identification and management of step-in risk, published in October 2017. The PRA proposes that the implementation date for the changes resulting from the proposals on step-in risk would be 1 January 2026.

The paper also sets out the PRA’s proposals to transfer the EBA guidelines on ‘limits on exposures to shadow banking entities’ and on ‘connected clients’ to PRA rules and supervisory statements. Firms are expected to make every effort to comply with the existing EBA guidelines, and the PRA expects firms to continue to meet these expectations and requirements once these guidelines are transferred into the proposed supervisory statements and PRA rules.

UK ‘competitiveness’ changes

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

Industry awaits HMT’s final policy on this and further consultations on transferring the remaining parts of the Capital Requirements Regulation and Capital Requirements Directive which were retained at the point of the UK’s exit from the EU into the PRA’s Handbook throughout 2024.

UK Strong and Simple Regime

The PRA continues its work on developing a proportionate prudential framework for PRA-regulated banks and building societies that are not systemically important and are focused on deposit taking from, and lending to, households and corporates in the UK. The PRA has stated that the development of this new regime will be a multi-year initiative.

The PRA anticipates a layered prudential regime, with the requirements applicable to what the PRA now terms 'small domestic deposit taker' firms (SDDTs) being the most proportionate through to the application of rules based on the Basel framework applicable to the more sophisticated, large or complex firms.

The scope of the SDDT regime was confirmed by the PRA in December 2023 together with the PRA's policy on liquidity and disclosure requirements for SDDTs. This is 'phase 1' of the development of the new regime. We expect proposals on 'phase 2' – simplifications to Pillar 2 and buffer requirements in Q2 2024.

Firms meeting the SDDT criteria and consolidation entities meeting the SDDT consolidation entity criteria can apply for a modification by consent from 1 January 2024. The PRA has published the forms firms can use to apply on their modifications and waivers webpage.

The disclosure rules also apply from 1 January 2024, whereas the liquidity rules will apply as of 1 July 2024. SDDT firms will not be required to implement the Basel 3.1 reforms but may choose to do so if they wish. If they do not implement Basel 3.1, they will continue to apply the existing Basel III rules until the SDDT capital regime is implemented (anticipated in H1 2026).

When the PRA consults on further potential simplifications for SDDTs and SDDT consolidation entities, it intends to do so on the basis of proposing that simplifications would apply to SDDTs and SDDT consolidation entities without SDDTs or SDDT consolidation entities needing to consent to a further modification. For example, the PRA proposes exempting SDDTs and SDDT consolidation entities from the proposed requirement to manage step-in risk.

Ring-fencing

The UK's ring-fencing regime has been in force for nearly four years. The legislation introducing the regime required an independent review to be undertaken following implementation, and in March 2022, the final report of the Ring-fencing and Proprietary Trading Independent Review, led by Keith Skeoch (the Skeoch Review) was published. The Skeoch Review addressed itself to an existential question – whether ring-fencing is really necessary in the post-global financial crisis era given other regulatory developments (in particular in recovery and resolution) – and to a series of narrower questions around the technical operation of the regime.

On the existential question, recognising the increasing alignment and overlap between recovery and resolution, the Skeoch Review made a long-term recommendation to align the ring-fencing regime with the resolution regime. In March 2023, the Treasury published a call for evidence and subsequently published its response on 28 September. The interplay between the two regimes, and questions as to how far each secures financial stability and imposes costs, are complex and politically and commercially sensitive. The responses to the call for evidence reflect the divergence of views and interests across stakeholders, and as a result do not present a coherent way forward on the questions raised by the Skeoch Review. The government has indicated it will continue to consider options for reform over the medium-to-long term and will publish its policy response to the call for evidence in the first half of 2024.

On the technical points, the Skeoch Review made six near-term recommendations and the government announced a series of reforms in response as part of its 2022 Edinburgh Reforms. On 28 September 2023, the Treasury and the Prudential Regulation Authority (PRA) published consultation papers on proposed near-term reforms to ring-fencing measures. The government is consulting on near-term reforms in four main areas of the ring-fencing regime, and is inviting further evidence on areas where the Skeoch Review made recommendations but it did not consider that reforms should be made at present. In tandem, the PRA is proposing changes to reflect proposed alterations to the geographical scope of the regime. Further information can be found in our **briefing on the proposed reforms to the ring fencing regime**. The government proposes to lay legislation on the near-term changes before Parliament in early 2024 and for the changes to take effect immediately.

Recovery and resolution

2023 witnessed the first major test of the post-financial crisis frameworks with the resolution of Silicon Valley Bank and actions taken in respect of Credit Suisse. While the actions taken were ultimately successful in preserving financial stability, regulators will be considering what lessons can be learnt from the experience and whether any policy reforms should be considered.

In the UK, on 11 January 2024, HMT began consulting on proposals to 'enhance and keep up to date' the UK's Special Resolution Regime, in response to lessons learned from the March 2023 events. The government proposes to introduce a new mechanism which would provide for greater optionality in terms of sources of capital for a small firm and would be used alongside the existing resolution powers. The new mechanism would allow the BoE to use funds provided by the banking sector to cover costs associated with a resolution, including those associated with recapitalising and operating the failed bank. As with the current depositor protection arrangements, these funds would be provided by the FSCS as needed in the event of a failure, and subsequently funded by a levy on the banking sector. The government expects this would be used primarily to resolve small banks, given larger banks are already required to hold a certain amount of their own equity and debt that can be drawn on to recapitalise them when they fail. The deadline for comments is 7 March. The BoE has published a statement welcoming the consultation paper.

Separately, the Bank of England published an updated version of its 'approach to resolution' document, or 'Purple Book' in December 2023. One main theme of updates made to the Purple Book relates to the Resolvability Assessment Framework (RAF) introduced in 2019. Beyond this, the updated Purple Book reflects the UK's departure from the EU, seeks to give more information on the Bank's strategy and legal duties whilst preserving the flexibility required and discusses the barriers to resolution and resolvability outcomes. It also contains more information on attitudes to cross-border banking groups.

Resolvability Assessments

The major UK firms are in the midst of their second RAF cycle, with their second public disclosures and Bank of England statements due in June 2024. The Bank of England's assessment will reflect on the progress firms have made in addressing the findings from the first assessment and will monitor progress in maintaining and enhancing their ability to achieve the three resolvability outcomes. Although the Bank places significant importance on firms' ability to achieve all three resolvability outcomes on a continuing basis, it will focus in this assessment on the adequate financial resources outcome. This will focus on firms' capabilities to support a resolution transaction and to remove the MREL, valuations, and funding in resolution barriers to resolution.

Internal MREL/TLAC regime

The fixed 90% requirement for internal MREL prescribed by Article 92b of the CRR was revoked in the UK on 1 January 2024 using powers contained within the FSMA 2023. The government intends to consult fully on the future of the remainder of the onshored CRR TLAC regime in Q3 2024.

Solvent wind-down and solvent exit expectations

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

The PRA also proposes to introduce a new framework governing solvent exit planning for non-systemic banks and building societies. 2024 will see the finalisation of this new policy and firms preparing for the proposed implementation date of Q3 2025.

The SRB states in its work plan that 2024 will see it enter into a new phase of work. It will evolve from focusing primarily on resolution planning and preparation to include a new focus on operationalisation, resolution testing and crisis readiness. As the transition period set by the SRB for implementing the Expectations for Banks (EfB) ends, policy work in 2024 will build on achievements so far, on lessons learned from the application of existing policies and potential changes linked to the strategic review, and to the Crisis Management and Deposit Insurance (CMDI) package.

Resolution planning and assessments

Now that the SRB's EfB implementation period has ended, the SRB is moving from an approach that monitors banks' implementation of the resolvability capabilities set out in the EfB to an approach that monitors banks' maintenance of such capabilities. The SRB plans to commence its testing of banks' capabilities in 2024. This is also in line with the EBA requirements for banks to demonstrate compliance with the EBA Guidelines on improving resolvability which apply from 1 January 2024. Institutions are expected to submit their first self-assessment report by 31 December 2024.

The 2024 resolution planning cycle will run from April 2024, the first since the completion of the EfB for most banks. The SRB states that common priorities for the 2024 planning cycle will be the testing of valuation capabilities and liquidity and funding in resolution. In addition, the SRB's priority letters also point out bank-specific priorities, such as further enhancing the bail-in playbook and continuing the bail-in testing, continuation of the work on separability, as well as bank-specific areas for further progress. Preparation for the subsequent 12-month cycle, which will take place from April 2025, will also start in 2024.

Full less-significant institution (LSI) resolution planning coverage is expected in 2024, and the SRB will assess all draft LSI plans received.

Additionally, 2023 was the final year for the constitution of the Single Resolution Fund, for it to reach at least 1% of covered deposits in all participating Member States, and be fully mutualised. The SRB will proceed, in early 2024, with the assessment on whether the final target level for the SRF has been reached or not, and with any further collection of ex ante contributions if necessary.

MREL regime

The final MREL targets of the BRRD2 became binding on 1 January 2024 and the SRB urges banks to have a forward-looking funding plan to prevent any breaches of MREL targets from occurring.

In December 2023, the SRB published a consultation paper on the future of MREL. The consultation is part of the SRB's strategic review to ensure the SRB remains optimally equipped for the future, building on lessons learned from recent crises together with past SRB resolution cases. The consultation focuses on: (i) MREL adjustments for preferred resolution strategies relying on a combination of resolution tools; (ii) the Market Confidence Charge buffer; (iii) the monitoring of MREL eligibility; (iv) discretionary exclusions; and (v) long-term policy considerations.

Internal MREL

Amendments to the CRR made in 2022 by a regulation on the prudential treatment of G-SII groups with an MPE resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting MREL (the Daisy Chain Regulation), relating to the indirect subscription of internal MREL eligible instruments within resolution groups, apply from 1 January 2024.

The Daisy Chain Regulation introduces a requirement that intermediate parents along the chain of ownership should deduct from their own internal MREL capacity the amount of their holdings of internal MREL eligible instruments, including own funds, issued by their subsidiaries belonging to the same resolution group.

The Commission was required to conduct a review on the implementation of the indirect subscription of internal MREL eligible resources by the different types of banking group structures and adopt a legislative proposal, if appropriate. In April 2023, the Commission published a proposal for a directive to make certain targeted amendments to the BRRD and the SRM Regulation concerning MREL (the Daisy Chain Directive).

The Daisy Chain Directive proposes to remove the obligation, in specific circumstances, for resolution authorities to set MREL for banks whose resolution strategy is liquidation and to give resolution authorities the discretionary power to set internal MREL on a consolidated basis to a subsidiary of a resolution entity. In addition, the proposal introduces a specific MREL treatment for 'liquidation entities'. Those are defined as entities within a banking group earmarked for winding-up in accordance with insolvency laws, which would, therefore, not be subject to resolution action. The Council and the European

Parliament reached provisional political agreement on the proposals on 6 December. This needs to be confirmed by member states' representatives in the committee of permanent representatives (COREPER) and by the European Parliament. Once endorsed, the legal text will be consolidated and formally voted in both the European Parliament and the Council. The text will then be published in the Official Journal and enter into force 20 days later. The rules are intended to start applying six months later.

The EBA has consulted on revisions to the ITS on disclosures and reporting on MREL and TLAC with regard to the disclosures and reporting of information on daisy chains and prior permissions. The consultation closed in August. The EBA intends the amendments to apply from the later of June 2024 and six months after the entry into force of the amending implementing regulation.

Crisis management and deposit insurance

In April 2023, the Commission adopted proposals for amendments to the BRRD, DGSD and SRM Regulation resulting from its review of the EU bank crisis management and deposit insurance framework, with a focus on medium sized and smaller banks.

The package seeks to revise the powers of competent authorities to intervene in the affairs of banks that are in financial difficulty but that are not yet failing or likely to fail (FOLTF) and the application of the public interest assessment (PIA) as part of the process for determining whether to trigger resolution. It contains new provisions on the conditions for the use of public funds in the form of extraordinary public support and measures intended to promote the use of deposit guarantee schemes (DGSs) in resolutions.

There are proposed revisions to the hierarchy of claims in insolvency, to introduce a general depositor preference with a single-tiered ranking and revisions to the scope of DGS protection. The Commission does not intend to adjust the current coverage level of EUR100,000 per depositor per bank but there are provisions to harmonise the protection of temporary high balances.

The proposals seek to revise MREL provisions concerning issues including the use of subordinated eligible instruments, calibrating MREL for transfer strategies leading to a bank's market exit, and the power to prohibit certain distributions.

The Council and the European Parliament continue to consider the Commission's proposals.

CCP Recovery and Resolution

As the systemic importance of central counterparties (CCPs) has and continues to increase in the wake of the post crisis reforms, the importance of effective regimes for the recovery and resolution of such financial market infrastructure has been amongst the priorities of the reform agenda for some years now.

EU

The EU published Regulation 2021/23 on a framework for the recovery and resolution of central counterparties in the official journal in January 2021. The regulation mandated ESMA to develop technical standards and guidelines over the course of the following two years with the majority to be delivered by 12 February 2022 and the remainder by February 2023. By 12 February 2024, ESMA is to assess the staffing and resources needs arising from the assumption of its powers and duties in accordance with this Regulation and submit a report to the European Parliament, to the Council and to the Commission. The SRB will also continue to contribute to the resolution planning for CCPs throughout 2024, in accordance with its mandate under the Regulation 2021/23.

UK

In the UK, the Bank of England's existing resolution powers for CCPs have been enhanced by FSMA 2023. HMT will further develop the UK's CCP resolution regime throughout 2024 with a set of regulations covering compensation and valuation under the regime and the Bank will also publish statements of policy, as required under Schedule 11 of FSMA 2023. The policy outcome of the Bank's consultation on the proposed approach to its power to temporarily restrict or prohibit discretionary payments to shareholders or employees of recognised UK CCPs in severe circumstances is also anticipated in Q1 2024 with entry into effect upon publication.

On 10 January, HMT published its CCP Special Resolution Regime Code of Practice. The Code provides guidance on the Bank's approach to the use of the CCP Special Resolution Regime set out in Schedule 11 of FSMA 2023. This includes in relation to: (i) how the special resolution objectives are to be understood and achieved; (ii) the choice between different stabilisation options; (iii) the information to be provided in the course of a consultation being carried out by the Bank; (iv) how to determine whether the resolution conditions have been met; (v) how to determine whether the test of the use of stabilisation powers is satisfied; and (vi) compensation, including how HMT intends to satisfy the "No Creditor Worse Off" requirement.

Outsourcing and operational resilience

Operational resilience remains a priority for the UK's regulators. Firms will have identified their important business services, set impact tolerances and identified vulnerabilities under the framework published by the FCA and PRA in March 2021. Firms are now well into the transitional period and should be making good progress towards compliance with the rules requiring them to remain within their impact tolerance(s) for each important business service in the event of a severe but plausible disruption, by no later than March 2025. The PRA expects firms to have a clear plan to identify and remediate any vulnerabilities which could impact their ability to deliver their important business services.

The resilience of third-party service providers deemed critical to the financial services market is also an area of focus for the legislators and regulators. FSMA 2023 establishes a new framework for regulating critical third parties (CTPs). The UK regulators published a joint discussion paper on how they could use their new powers in July 2022 and a joint consultation in December 2023. The consultation closes in March 2024. Given the focus on operational resilience, we are likely to see further policy in this area in 2024, not least a draft statement of policy on the regulators' approach to the use of disciplinary powers and the final rules and expectations for CTPs. We may even see the designation of certain services providers as "critical third parties" which would trigger the statutory obligations of the CTP under FSMA and the regulators' rules and expectations.

In February 2023, the Bank of England finalised its policy on outsourcing and third-party risk management for Financial Market Infrastructure. The policy has been issued in the form of Supervisory Statements (SSs) for central counterparties (CCPs), central securities depositaries (CSDs), and recognised payment system operators (RPSOs) and specified service providers (SSPs). FMI are expected to comply with the expectations in their respective SS by 9 February 2024. Outsourcing arrangements entered into on or after 8 February 2023 should meet the expectations in the SS by 9 February 2024. FMI should seek to review and update legacy outsourcing agreements entered into before 8 February 2023 at the first appropriate contractual renewal or revision point to meet the expectations in this SS as soon as possible on or after 9 February 2024.

The regulators also intend to issue a joint consultation on incident and outsourcing and third-party reporting in H2 2024. The stated purpose is to introduce clarity regarding the information firms should submit when operational incidents occur and to collect certain information on firms' outsourcing and third-party arrangements in order to manage the risks they may present to the PRA/FCA's objectives.

On 16 January 2023, the Digital Operational Resilience Act (DORA) entered into force. It will apply from 17 January 2025 and aims to harmonise provisions relating to digital operational resilience across the EU financial sector. DORA also aims to raise awareness of ICT risks, acknowledging that ICT incidents and a lack of operational resilience have the possibility to jeopardise the soundness of financial entities and of the financial sector. DORA implementation will be a major focus for EU financial sector firms over 2024, and will also be likely to affect their suppliers and counterparties as a number of obligations will require changes to supply arrangements.

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

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

AML/Financial crime

AML package

The key reforms in the European Commission's package of AML and CTF legislative proposals include establishing a new EU AML and CTF authority (which the European Commission refers to as the AMLA). The AMLA will be a central authority coordinating all national AML and CTF supervisors (not just those in the financial services sector), with a view to improving the effectiveness and consistency of AML and CTF supervision and enforcement. Although the AMLA will not replace national AML and CTF supervisors, it will have some direct supervisory powers over certain high-risk financial institutions. The European Commission also proposes establishing a new AML and CTF Single Rulebook, comprised of a Regulation on anti-money laundering and counter terrorism financing (AML Regulation) and the sixth Directive on AML/CTF (AMLD6).

The fourth MLD provisions that apply to obliged entities are being moved to the AML Regulation so that they become directly applicable provisions. Many provisions in the AML Regulation are also more detailed and granular than they are at present, and there will be more technical standards, which the AMLA is tasked with preparing. AMLD6 will repeal and replace the fourth MLD, as amended by AMLD5, and complement the AML Regulation. It contains provisions that organise the institutional AML and CTF system at a national level, including provisions on the powers and tasks of national supervisors, as well as the establishment and access to beneficial ownership and bank account registers. These provisions will remain in a Directive in recognition of the fact that Member States need flexibility in this area. However, some of the provisions are more detailed to improve consistency in implementing the AML and CTF regime, facilitate the creation of an integrated EU supervisory mechanism, and improve detection of suspicious flows and activities.

The timing of the AML package has been delayed. However, the European Parliament and Council of the EU have now reached provisional agreements on the proposed Regulation establishing the AMLA, on MLD6 and on the AML Regulation. The texts of the provisional agreements will now be finalised and presented to Member States' representatives in the Committee of Permanent Representatives and the European Parliament for approval. If approved, the Council of the EU and the European Parliament will have to formally adopt the texts before they are published in the EU's Official Journal and enter into force.

The recast revised Wire Transfer Regulation (the recast revised WTR) extends the scope of the 'travel rule' to the transfer of certain cryptoassets. It will make the abuse of funds and certain cryptoasset transfers for terrorist financing and other financial crime purposes more difficult and enable relevant authorities to fully trace such transfers to prevent, detect or investigate AML/ CTF. The recast revised WTR entered into force on 29 June 2023 and applies from 30 December 2024. Regulation (EU) 2015/847 (revised WTR) will then be repealed on that date.

On 24 November 2023, the EBA began consulting on draft guidelines on preventing the abuse of funds and certain cryptoassets transfers for AML/CTF purposes pursuant to the recast revised WTR. These 'travel rule' guidelines specify the steps that payment service providers (PSPs), intermediary PSPs, cryptoasset service providers (CASPs) and intermediary CASPs should take to detect missing or incomplete information that accompanies a transfer of funds or cryptoassets. They also detail the procedures all these providers should put in place to manage a transfer of funds or a transfer of cryptoassets that lacks the required information. The guidelines aim at forging a common understanding to ensure the consistent application of EU law as well as a stronger AML/CTF regime. The consultation closes on 26 February 2024.

UK review of AML and CTF regime

In June 2023, HMT published a consultation on the reform of the anti-money laundering and counter-terrorism financing supervisory system, in line with a commitment in the Economic Crime Plan 2023-6.

The consultation builds upon a 2022 review of the UK's AML/CTF regulatory and supervisory regime, which concluded that weaknesses in supervision may need to be addressed through structural reform. This consultation develops and seeks to assess four models proposed in the 2022 review. Additionally, HMT sought views on whether to expand requirements on supervisors and their regulated populations relating to sanctions compliance. HMT expects to publish a response document setting out its policy decision and key implementation considerations in Q2 2024.

The Economic Crime Plan 2023-6 also sets out the government's intentions for 2024 in relation to, amongst other items, (i) the delivery of a new SARs database and law enforcement analytical tools, (ii) establishing an intelligence exchange hub in support of cross-border asset recovery, (iii) driving improvements in firms' sanctions systems and controls through further development of the FCA's intelligence and data led approach, and (iv) exploring engagement with Environmental, Social, and Governance (ESG)-related agencies on how intelligence on the scale and source of monies associated with environmental crimes can be shared to help identify and combat those crimes and associated money laundering.

The Economic Crime and Corporate Transparency Act 2023

The Economic Crime and Corporate Transparency Act 2023 received Royal Assent in October 2023. It is an important legislative development in the UK's fight against economic crime with the introduction of a new 'failure to prevent fraud' offence and amendments to the 'identification principle' relevant to corporate liability. Please see our **bulletin** for more information. The Act also provides additional powers to law enforcement so they are able to more quickly and easily seize and recover cryptoassets which are the proceeds of crime or associated with illicit activity such as money laundering, fraud and ransomware attacks. Most of the substantive provisions of this new Act will be brought into force by secondary legislation, so we expect further developments in this area in 2024.

International

Digital fraud and banking

In November 2023, the BCBS issued a discussion paper on digital fraud and banking. The paper provides a high-level assessment of the supervisory and financial stability implications of digital fraud for the global banking system. It is structured around topics including what digital fraud is, its main defining features and its effect on banks, the supervisory and financial stability implications and the relevance of digital fraud to the BCBS mandate, and what initiatives in the banking sector at a domestic, regional and global level have been pursued, or are planned, to mitigate digital fraud risks. The paper does not make a formal distinction between retail and wholesale digital fraud. While most of the paper is primarily focused on retail, the BCBS considers that there are also some elements that may have a connection to wholesale digital fraud. The consultation closes on 16 February 2024.

Financial markets

Primary Markets

Listing Rules Reform

Significant progress is expected in 2024 in the UK as a result of the FCA's Primary Markets Effectiveness Review. During 2023, the FCA published six engagement papers on this topic, followed by, in December, a consultation on detailed proposals for listing rules reforms covering the first tranche of changes to be included in a new UK Listing Rules Sourcebook and proposals in relation to sponsor competence.

As was expected, the current premium and standard listing segments will be replaced by a single listing segment for equity shares in commercial companies and there will be a shift towards a disclosure-based regime. Other key changes proposed are: (i) removal of premium listing financial eligibility requirements relating to historical financial information, revenue track record and a clear working capital statement; (ii) significant removal of requirements in relation to significant transactions; (iii) removal of the requirement for shareholder approach in the context of related party transactions; and (iv) simplification of requirements in relation to independent business and operational control. The proposals regarding sponsor competence are expected to be implemented within the current Listing Rules in Spring 2024, and the final rules are expected to be published with a policy statement at the start of the second half of 2024, with a short period of two weeks before implementation.

Prospectus Regulation Review

Similarly, significant progress is expected in 2024 in the UK following the laying in parliament of the Public Offers and Admissions to Trading Regulations 2023 on 27 November 2023.

The new framework will set out a general prohibition on public offers of securities and various exemptions which then may be applied, with the FCA granted power to make rules in relation to these exemptions. The key areas where the FCA is expected in 2024 to consult on rules made using this new power are: (i) admissions of securities to trading on a regulated market; (ii) admissions of securities to trading on primary multilateral trading facilities; and (iii) requirements for firms operating a public offer platform (a new regulated activity).

EU Listing Act package

The EU Listing Act package was originally proposed in December 2022, and is currently in the trilogue negotiation phase. There is a general expectation that an optimistic timeline will be pursued in order to agree the final text ahead of the EU Parliamentary elections in June 2024.

The EU Listing Act package proposals relate to MiFID/MiFIR and MAR (see below), but notably seek to streamline the existing listing process with a focus on increasing the attractiveness of the capital markets for small and medium-sized enterprises. In terms of the listing and prospectus aspects, the key amendments relate to enabling issuers to produce and deliver prospectuses more easily and making changes to allow multiple-vote share structures to be used to raise funds more readily. The proposals include the repeal of the EU Listing Directive with respect to coordinating the conditions for admission of securities to official stock exchange listings.

MiFID/MiFIR

Wholesale Markets Review

The Financial Services and Markets Act has now made various changes implementing outcomes of the UK's Wholesale Markets Review (WMR), such as the removal of the UK share trading obligation and synchronising the scope of the UK derivative trading obligation with the UK EMIR clearing obligation. However, many changes are architectural and responsibility for the regulatory implementation sits with, or has now been transferred to, the FCA. There have been a number of consultations over the course of 2023, and accordingly some changes have already been made (for example, the new FCA trading venue perimeter guidance), there are some changes scheduled to come into force in 2024 and other changes expected to be confirmed in the course of 2024.

In terms of changes scheduled to come into force in 2024, the new designated reporter regime and the changes to the equity transparency regime will, in the main, come into force on 29 April 2024. The FCA has also published its policy statement and final rules on a UK consolidated tape for bonds. The rule changes will come into force on 5 April 2024, and a tape is expected to be developed during the course of 2024.

There are also (at the time of writing) open consultations in relation to three key WMR topics: (i) updating the position limits regime and ancillary activities exemption for commodity derivatives, which closes on 16 February 2024; (ii) reforming the transparency regime for non-equities (this consultation also proposes new guidance on the amended UK definition of systematic internalisers), which closes on 6 March 2024; and (iii) a follow-up consultation on payments to and forms for data reporting service providers, which closes on 9 February 2024.

Investment research

The question of whether the MiFID-derived restrictions on the receipt and payment for investment research should be amended has been a key feature of the UK's SRF considerations. In July 2023, the Kent Investment Research Review was published, which looks at this question, as well as reviewing more broadly the quality and use of investment research in the UK and possible improvements. In relation to the receipt of and payment for investment research, the Review recommended changing the existing UK restrictions to add in payment optionality for firms (ie allowing firms to receive, as was permitted pre-MiFID II, bundled research and giving flexibility to firms engaging with research providers in other jurisdictions such as the US).

Looking ahead to 2024, the FCA has committed to progressing this recommendation on an accelerated timeline and is expecting to consult on new rules in Q1 2024 and to make final rules in H1 2024. In terms of the other recommendations, which relate to: (i) introducing a research platform; (ii) access to research for retail; (iii) support from academic institutions; (iv) a code of conduct for issuer-sponsored research; (v) a bespoke UK regime for investment research; and (vi) IPO investment research, HMT and the FCA are engaging with industry and market stakeholders on these specific topics, although there has been no commitment to timeframes for progressing these other areas.

EU

MiFID Review

2023 saw significant progress on the EU's review of MiFID, which originally had the following focuses: (i) adjustments to the scope of the share trading obligation and the derivatives trading obligation; (ii) payment for order flow (PFOF); (iii) pre- and post-trade transparency for equities and non-equities; (iv) market data and consolidated tape provision; (v) deletion of RTS 27 best execution reports; and (vi) deletion of the licensing requirement for firms trading via DEA and dealing on own account.

In June 2023, the EU Council and EU Parliament agreed that: (i) PFOF would be banned, subject to the possibility for member states to exempt firms from the ban where PFOF arrangements already exist, and only in relation to clients in that member state until 30 June 2026; (ii) EU-level consolidated tapes would be established in relation to certain financial instruments; and (iii) certain updates would be made to the commodity derivatives regime.

The agreed EU MiFIR and EU MiFID texts were published in October 2023. In terms of timings for 2024, the amending regulation and directive texts are expected to be published in the OJ around the end of Q1 2024, coming into force 20 days thereafter.

Over the course of 2024, there will be a number of consultations in respect of the necessary Level 2 work that is required to support the Level 1 changes, meaning various delegated acts will only be adopted in 2025 or later. ESMA has also confirmed that for the first EU consolidated tape (which will be for bonds), it expects to launch the selection process in Q4 2024 (with the selection process for equities and derivatives coming later). It is however expected that ESMA would be required to publish the register of 'designated publishing entities' by October 2024 (a new status akin to the UK's new designated reporter regime, allowing firms to be responsible for publishing transactions without needing to be classified as a systematic internaliser).

Investment research

The EU Listing Act Package (also referred to in the MAR section below) proposes various amends to MiFID in relation to access to capital for small and medium-sized enterprises, including (among other things) rules around investment research (including issuer-sponsored research) in the context of small and medium-sized enterprises. In particular the EU Listing Act Package proposes amending the MiFID rules on bundled research so that they would only apply to companies with a market capitalisation of EUR10bn.

EU Retail Investment Strategy

The EU Commission proposed the EU Retail Investment Strategy package in May 2023. It seeks to make amendments across a range of retail-centric measures within the EU regulatory framework for financial markets and investment management, including MiFID/MiFIR but also PRIIPs, UCITS, and AIFMD. As a high-level overview, the package seeks to address the following potential areas for improvement which impact retail investors: (i) disclosure rules; (ii) value assessment; (iii) conflicts of interest and inducements; (iv) financial advice; (v) marketing; (vi) financial literacy; and (vii) professional investor categorisation. During 2024, it is expected that significant progress will, ideally, be made in Q1 to agree the final texts ahead of the Parliamentary elections in Q2, and ESMA has confirmed that in 2024 it will be assisting with preparatory work for the implementation of the EU Retail Investment Strategy, as may be required. The potential changes would have a significant impact on investment management firms in particular (even those with no direct retail client relationship).

MAR

Inside information

On 7 December 2022, the European Commission proposed its new Listing Act Package which (among other things) amends EU MAR. Key amendments under the proposal relate to post-IPO disclosure obligations around inside information and the maintenance of insider lists. Further changes proposed include raising the annual threshold above which transactions conducted by Persons Discharging Managerial Responsibilities and Persons Closely Associated must be notified to the issuer and competent authorities.

In Q4 2023, the EU Council and EU Parliament confirmed their mandates to start inter-institutional negotiations to agree the finalised texts and trilogues are expected to take place during the course of 2024.

Pre-hedging

On 29 July 2022, ESMA published a call for evidence on pre-hedging to help it develop appropriate guidance. The conclusions of ESMA's call for evidence on pre-hedging were then published in July 2023, finding that there was no need for a ban but noting that there were risks of market abuse around the practice. However, please note comments on pre-hedging developments in the Global section below.

Global

Pre-hedging

In Q4 2023, IOSCO published its survey on pre-hedging (which closed to industry responses on 22 December 2023), with a view to developing recommendations to raise standards, encourage alignment between jurisdictions and address any need for market guidance. There is evidence of interest in and appetite for guidance on the line between acceptable and unacceptable pre-hedging activities (and when activities might comprise frontrunning, or otherwise fall foul of market abuse principles and requirements) – although there are certain industry standards already in existence, such as the FX Global Code and the FMSB Standard on Large Trades in FICC Markets.

To date, there has been cross-industry and market collaboration in responding to IOSCO and it is expected that this work will be advanced in 2024. However, no definite timeline has been confirmed by IOSCO.

EMIR

UK EMIR Review

HMT confirmed in Q4 2023 that UK EMIR will be in Tranche 3 of the UK's SRF implementation programme, and so the general expectation is that 2024 will see some movement on this front. While no specific timeline for this work has been officially confirmed, there is, currently, regulator engagement with industry as to the issues that may be covered as part of the UK EMIR review. Very broadly speaking, the review is expected to cover many similar topics and concerns as those covered by EMIR 3.0 (see non-exhaustive list in the EU section below) – a key exception to this being the proposed EU EMIR 3.0 active account requirement.

Additionally, the margin exemption for single stock equity and index options (originally due to expire 4 January 2024) has been extended to 4 January 2026.

EMIR 3.0

In Q4 2023, the EU Parliament and EU Council published their respective negotiating positions in relation to the EU Commission's EMIR 3.0 legislative proposals (an amending directive and amending regulation). As a reminder, the stated aim of the EMIR 3.0 proposals is to encourage clearing in the EU, enhance EU CCP attractiveness, and reduce reliance on non-EU CCPs. The main proposal receiving the most commentary and focus is the new active account requirement, which would force firms to carry out a certain amount of clearing in the EU (reducing reliance on non-EU (and particularly UK) clearing).

In December 2023, political and technical trilogues commenced. The key issues under discussion are: (i) the new active account requirement; (ii) margin requirements exemption for equity options; (iii) clearing obligation exemption for post-trade risk reduction services; (iv) availability of exemptions for cross-border intragroup transactions; (v) equivalence (and deference) considerations; (vi) scope of validation of initial margin models requirements; (vii) clearing threshold calculation for non-financial counterparties; (viii) acceptance of uncollateralised bank guarantees for non-financial counterparties by CCPs; (ix) reporting exemption for non-financial counterparties for intragroup transactions; (x) EU Parliament proposals regarding clearing members, margin models and public sector entity participation; (xi) trade repository reporting for non-EU members of a group subject to consolidated supervision; and (xii) annual reporting requirements. Please note that this is not an exhaustive list.

The trilogue phase of the legislative procedure began in December 2023. It is expected that the final text will be agreed in Q2 2024, and published in the Official Journal of the European Union. The EMIR 3.0 regulation and directive will then come into force on the 20th day following publication.

As in the UK, the margin exemption for single stock equity and index options (originally due to expire 4 January 2024) has been extended to 4 January 2026.

Financial market infrastructure (FMI) Regulation

UK CCP and CSD Regulation

FSMA 2023 establishes a new framework for the Bank of England's regulation of financial market infrastructures, including CCPs and CSDs. In December 2023, the Bank published a consultation paper on its approach to using its new power to issue requirements to recognised UK CCPs and CSDs and systemic third-country CCPs. The new power means the Bank may require a relevant CCP or CSD to take an action, or refrain from an action and is a different power from the Bank's existing powers of direction. The new power may be used in order to advance the Bank's financial stability objective and/or where the relevant CCP/CSD has failed or is likely to fail to satisfy any recognition requirements or other obligation under FSMA 2000. The Bank expects to publish its finalised statement of policy on this in 2024.

Broadly, given the systemic and global nature of FMI services, a bonfire of UK-specific regulation in this space is not expected. However, in light of the extent of international scrutiny of FMIs and their operations, and the changing landscape beyond the UK (including EU EMIR, digital assets and accelerated settlement developments, for example), 2024 will again be a year in which such firms will need to keep abreast of the global regulatory horizon and assess the potential practical impact.

FSMA 2023 also introduces a Senior Manager and Certification Regime (SM&CR) framework for FMIs (including CCPs, CSDs, recognised investment exchanges and credit rating agencies), and the Regulatory Initiatives Grid (published November 2023) confirmed that HMT and the regulators will be considering the outcomes of the HMT Call for Evidence and the FCA and PRA joint Discussion Paper (both of which closed to comments on 1 June 2023) before taking further action.

FMI Sandboxes

FSMA 2023 introduces a framework for regulatory sandboxes to allow FMIs to test innovative market infrastructure technologies, including digital asset and distributed ledger technology operations and systems.

On 8 January 2024, the Financial Services and Markets Act 2023 (Digital Securities Sandbox) Regulations 2023 came into force, creating the first FMI sandbox (the Digital Securities Sandbox, or DSS) in accordance with the framework introduced in FSMA 2023. The DSS will allow FMIs to test developing technologies and operate within a modified regulatory framework, with key temporary changes made to FSMA, UK CSDR, the UK Companies Act and the USRs 2001. The purpose is to enable participants to carry out certain FMI activities including operating a trading venue, maintenance, notary and settlement activities, and other ancillary activities, in relation to digital assets and related innovative technologies. Currently, applicants are able to contact HMT to express their interest in the DSS but no application process has yet been set out by the regulators (being the Bank of England and the FCA); this is expected to be confirmed in 2024.

In Q4 2023, the regulators confirmed that a further FMI sandbox will be developed in the course of 2024 for the development of a new intermittent trading venue (the ITV Sandbox). The proposal for an intermittent trading venue was discussed as part of HMT's Wholesale Markets Review (see above). The ITV Sandbox is expected to be in place from October 2024 to March 2025.

EU CSDR Refit Regulation

The EU CSDR Refit Regulation was adopted on 27 November 2023. The key amendments being made to the existing CSDR relate to: (i) passporting; (ii) supervisory cooperation; (iii) ancillary services; (iv) settlement discipline (including changes in relation to mandatory buy-ins); and (v) supervision of third-country central securities depositories. Certain of these will come into force as of May 2024 with other provisions coming into force in 2026.

Under the CSDR Refit, ESMA was mandated to publish a report on accelerated settlement – see below on ESMA's 2023 call for evidence.

Accelerated Settlement

UK Accelerated Settlement Taskforce

In December 2023, the Chair of the UK Accelerated Settlement Taskforce wrote to Taskforce participants by way of an update on the Taskforce's progress to date, since its establishment in December 2022. The Chair's letter confirms his intention to create a Technical Group under the Taskforce's auspices, and suggests some key themes for this Technical Group to examine, in summary: (i) scope; (ii) operational processes and deadlines; (iii) FX issues and overseas investors; (iv) stock lending and recalls; (v) repos; (vi) trading and liquidity issues; (vii) corporate actions; (viii) infrastructure resilience; (ix) alignment issues/risks with the US and EU; and (x) lessons learned from the US's experience of moving to T+1 (the US and Canada deadline being May 2024).

The letter confirms that over the course of 2024, work will progress on phase 1 of the work, being establishing market standards and confirming actions that need to happen on the date of the trade. The letter also confirms that the UK Accelerated Settlement Taskforce report of initial findings (originally scheduled for December 2023) will be published in Q1 2024, and will contain recommendations and a list of questions for further consultation.

ESMA Accelerated Settlement Call for Evidence

In Q4 2023, ESMA published a call for evidence seeking stakeholder views and quantitative evidence on the costs and benefits of reducing the securities settlement cycle in the EU from the current T+2 cycle to T+1 or T+0. There is naturally an extensive overlap with the issues being considered in the UK, including the impact of non-alignment with cycles in other jurisdictions. The call for evidence sets out that expected next steps for 2024 will be for ESMA to consider feedback in Q1, and then publish a final report by Q4 2024.

The call for evidence also confirms that there may be some areas where it reports sooner than the above expected next steps timeline. This is in relation to international developments on settlement cycles, including not only the US and Canada move to T+1, but also China's transition to T+0 on Interbank Market government bonds, India's transition to T+1 for shares traded on exchange, and the UK's possible move (as described above).

Payment services and payment systems

Future of Payments Review

In July 2023, the Future of Payments Review was launched as part of the Mansion House Reforms. HMT published a report on the review on 22 November 2023. Overall, feedback to the review was that the UK payments landscape is in a good position but lacks vision and clear priorities. Therefore, the report's strongest recommendation is that the UK government develops a national payments vision and strategy to bring clarity to its future desired outcomes for UK payments, with the primary aim of simplifying the landscape over time.

The review observes that the UK has a relatively mature banking, cards and digital wallets environment, and a well-developed regulatory environment. However, consumer experience could be improved, specifically in relation to the strong customer authentication requirements consumers experience at the point of purchase. The report highlights that there are concerns with digital exclusion that could be adding to the financial exclusion problem, i.e. access to cash, and asks that HMT and the FCA closely monitor the situation. HMT discusses that the consumer-to-consumer bank transfer process is clunky and in need of improvement. In addition, many merchants and retailers are frustrated by the costs of taking card payments and the lack of viable alternatives. The review also finds that there should be an increased emphasis on preventing crime in the first place, suggesting that the Payment Systems Regulator (PSR) conducts a review of the new authorised push payment (APP) fraud rules after 12 months of implementation and that the UK government sets a more ambitious fraud crime reduction target beyond 2024.

The Chancellor's 2023 Autumn Statement confirmed that the UK government will publish a National Payments Vision this year. Building from the review's findings, this will include consideration of priorities for UK payments and, working with the PSR and the Bank of England, will consider the role of the New Payments Architecture.

Contract termination rule changes

HMT has published a policy statement in relation to the implementation, timings and next steps for payment service contract termination rule changes. The changes include extending the notice period for termination of a framework contract from two months to 90 days and mandating that providers give a clear and tailored reason for termination. HMT has provided details of how the proposals will be implemented, including: (i) it will principally require amendments to Regulation 51 of the Payment Services Regulations 2017 (PSRs); (ii) clear and tailored explanatory reasons should be provided in cases where a provider decides to terminate a contract for the provision of a payment service, except in limited scenarios, including where to do so would be unlawful, inconsistent with wider legal and regulatory requirements, or would present risk of significant or serious harm to the customer or another individual; (iii) the corporate opt-out in Regulation 40(7) of the PSRs will apply in respect of the new requirements, however, the UK government's position is clear that firms should as standard practice default to offering 90 days' notice and clear and tailored explanatory reasons; and (iv) the UK government will take an outcome-based approach and therefore does not intend to prescribe the specific information that should be provided to a customer.

Review of PSRs and call for evidence

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

Changes to safeguarding requirements

Strengthening safeguarding requirements for payments and e-money institutions using enhanced rule-making powers was conferred on the FCA as part of the Smarter Regulatory Framework Review. The FCA expects to publish a consultation paper in the first half of this year. A policy statement and final rules are expected to be published in H2 2024, subject to consultation and relevant legislative changes being made by HMT.

Open banking

In April 2023, the Joint Regulatory Oversight Committee (JROC), made up of the FCA, PSR, CMA and HMT, set out its recommendations for the next phase of open banking in the UK. The report includes a roadmap of 29 actions relating to five key themes that will be progressed over the next few years: (i) levelling up availability and performance; (ii) mitigating the risks of financial crime; (iii) ensuring effective consumer protection if something goes wrong; (iv) improving information flows to third-party providers and end users; and (v) promoting additional services, using non-sweeping variable recurring payments as a pilot.

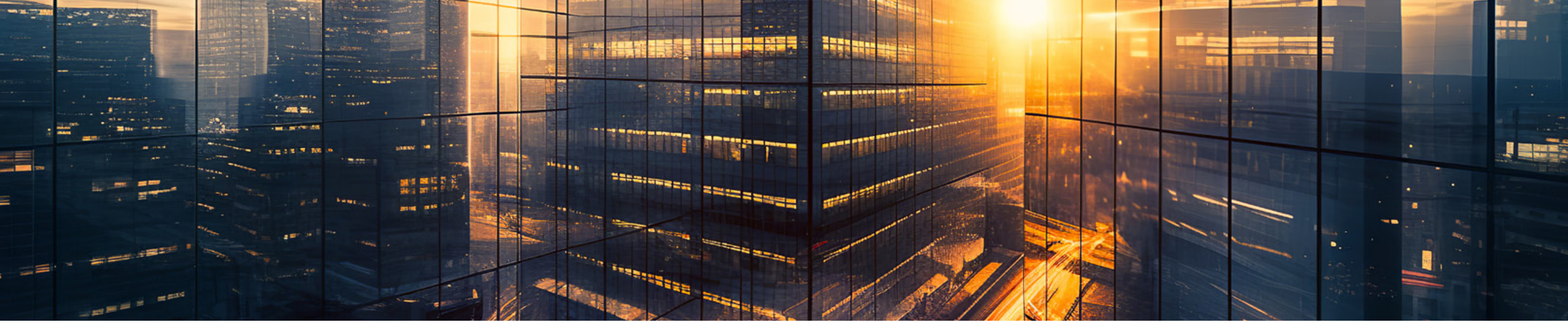
The JROC has highlighted that it will collectively improve visibility and understanding around the level of financial crime across the open banking ecosystem and the availability and performance of application programming interfaces across different account servicing payment service providers. The PSR will also improve the functioning of the ecosystem – for instance, by ensuring consistent error messaging.

In June 2023, the JROC set out a programme of work to take these recommendations forward. This includes the creation of two regulator-led working groups, focusing on developing the framework for the expansion of variable recurring payments and the design of the future open banking entity. The UK government is taking steps to establish the long-term regulatory framework as soon as Parliamentary time allows and intends to put forward legislation this year.

The report on the Future of Payments Review discusses that while open banking could help improve the consumer-to-consumer process and provide an alternative to the card schemes for retailers, it currently lacks a consumer dispute resolution process for open banking transactions, which could be a barrier to adoption if not addressed. The same is true of the current commercial arrangements, which the report concludes do not create the conditions for open banking to thrive in a healthy way, with costs and benefits misaligned.

At the end of last year, the PSR began consulting on extending variable recurring payments (VRPs) to additional low-risk use cases. VRPs enable customers to safely connect authorised payment providers to their bank account using open banking so that they can initiate recurring payments. The CMA mandated nine UK banks to implement VRPs for payments between accounts belonging to the same person (sweeping VRP), however, the PSR proposes to extend VRPs to enable payments between accounts in different names (non-sweeping VRP or commercial VRPs (cVRPs)). In phase 1, the PSR proposes to enable VRPs for payments to regulated financial services, regulated utilities sectors, and local and central government. The deadline for comments on the consultation is 2 February 2024. The PSR will consult again on updated policy proposals in 2024.

On 18 December 2023, the PSR published the VRP Working Group's blueprint for implementing cVRPs. In its response to the blueprint, the JROC stated that it largely agreed with the actions and sequencing set out in the blueprint and proposes the formation of two implementation groups, including a Dispute Resolution Implementation Group to develop a formal dispute resolution framework. By Q1 2024, JROC expects the implementation groups to create and agree a delivery plan with guidance and support from regulators to carry out and complete Phase 1 actions by Q3 2024.



Mandatory reimbursement for APP fraud

The PSR has confirmed its new mandatory reimbursement requirement for authorised push payment (APP) scams within the Faster Payments system. All payment service providers (PSPs) sending payments over Faster Payments will have to reimburse APP scam victims who are consumers, micro-enterprises or small charities, except where certain exclusions apply, such as the consumer standard of caution exception. The sending PSP will have to reimburse the victim and the receiving PSP must send 50% of the cost of a reimbursement claim to the sending PSP. Sending PSPs will be allowed to apply an excess up to GBP100 to a claim under the policy, except for claims made by vulnerable consumers. In addition, the sending PSP is not obliged to reimburse above the maximum level of reimbursement, which the PSR has set at GBP415,000, for a single APP scam case or to reimburse any APP scam claim where the customer submits the claim more than 13 months after making the last payment in the case. If the PSP has evidence or reasonable grounds for suspicion of either first party fraud or gross negligence on the part of the claimant, it will also have more time to investigate and can delay the payment.

Following several related consultations on different aspects of the new requirement, the PSR published a policy statement on 19 December 2023, setting out the final parameters of the new mandatory reimbursement requirement. The PSR has clarified the consumer standard of caution exception, which can apply only where the claimant is grossly negligent in one of four specific circumstances. These are the requirement to have regard to interventions by the PSP, to make prompt notification to their PSP, to respond to reasonable requests for information from their PSP and to report (or permit their PSP to report) to the police. This exception does not apply to vulnerable consumers. The PSR will also monitor the incidence and impact of high value APP scams over the coming months and may consult on revising the maximum reimbursement level ahead of the start date if there is convincing evidence to do so.

To implement the reimbursement requirement, the PSR has published three legal instruments: (i) Specific Requirement 1 – imposed on Pay.UK to include the reimbursement requirement in the Faster Payments scheme rules; (ii) Specific Direction 20 – given to direct and indirect participants in Faster Payments, obliging them to comply with the reimbursement requirement and the reimbursement rules; and (iii) Specific Direction 19 – given to Pay.UK to create and implement an effective compliance monitoring regime.

The PSR has confirmed that the start date for the reimbursement requirement will be 7 October 2024. It will set out next steps, which include a clarifications process, in Q1 2024, to encourage a consistent approach to implementation across industry. The Bank of England has also confirmed that it plans to implement measures for the reimbursement of victims of APP fraud that are comparable to those for Faster Payments within the CHAPS payment system.

Confirmation of Payee

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

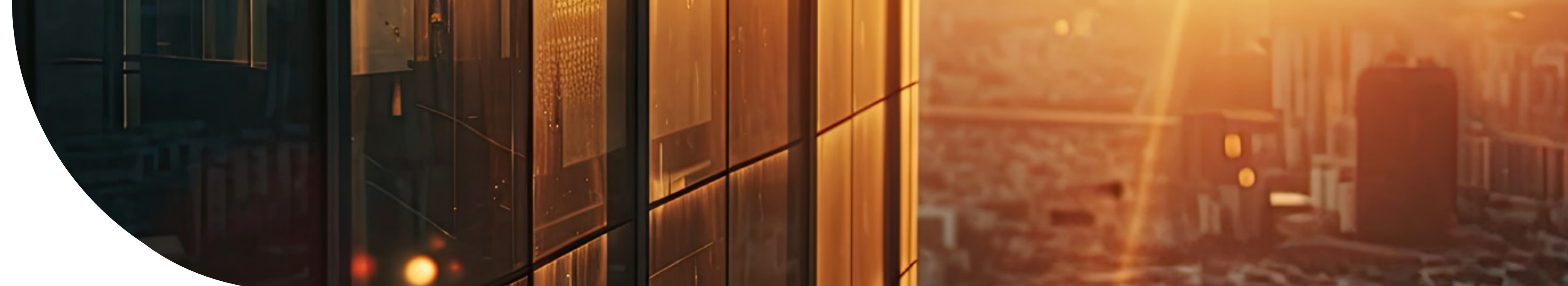
Market reviews into card fees

The PSR is carrying out two market reviews into card fees – one on card scheme and processing fees and one on cross-border interchange fees. The market review of card scheme and processing fees looks in detail at the levels, structure and types of scheme and processing fees. The PSR expects to publish a report setting out its interim conclusions on card scheme and processing fees shortly and a final report, which would include any proposed remedies, in Q2 of 2024.

The PSR's second market review focuses on consumer cross-border interchange fees between the UK and the EEA. The PSR wants to understand the reason behind the increase in fees associated with some UK-EEA payments, as well as to engage with businesses to better understand how the increases are impacting them. The PSR published a report setting out its interim conclusions on UK-EEA consumer cross-border interchange fees on 13 December 2023. The PSR is proposing to introduce a price cap to protect UK businesses from overpaying on these interchange fees. Subject to the PSR's final report and further consultation on remedies, this could happen in two stages: (i) an initial time-limited cap of 0.2% for UK-EEA consumer debit transactions and 0.3% for consumer credit transactions (where the transactions are made online at UK businesses); and (ii) a lasting cap on these interchange fees in the future, once further analysis has been carried out to establish an appropriate level. The PSR expects to publish its final report in Q1 of 2024.

Payments regulation and the systemic perimeter

In 2022, the UK government consulted on the regulatory perimeter for payments, in particular bringing systemically important firms in payment chains into Bank of England regulation. The UK government published its response to the consultation on 7 August 2023. In its response, HMT confirmed that it will legislate to reform the systemic payments perimeter, and HMT will issue a further public statement setting out its legislative approach. The Bank of England is also expected to set out its approach for how it will supervise over its expanded remit once the relevant legislation is published. In addition, the UK government confirmed that it plans to set out its next steps on the extension of the Senior Managers and Certification Regime (SM&CR) to recognised systemic payments entities and authorised PSPs and e-money institutions (EMIs), once its broader review of the SM&CR has been concluded. It will also bring forward secondary legislation to reform the PSR's payment system access framework.



Payments and financial data access package

On 28 June 2023, the European Commission published the texts of legislative proposals that it has adopted concerning reforms to EU payment services and to implement a framework for financial data access. The first proposal is a directive on payment services and electronic money services (PSD3) which will modernise and repeal the revised Payments Services Directive (PSD2) and the revised Electronic Money Directive (EMD2). The package will also establish a new Payment Services Regulation (PSR1).

PSD3 establishes the licensing and supervisory requirements for payment institutions. PSR1 lays down the conduct rules for payment and electronic money service providers offering payment and electronic money services in the EU. The package of measures consists of: (i) merging the legal frameworks applicable to electronic money and to payment services; (ii) strengthening measures to combat payment fraud by enabling PSPs to share fraud-related information between themselves, strengthening customer authentication rules, extending refund rights of consumers who fall victim to fraud and making a system for checking alignment of payees' IBAN numbers with their account names mandatory for all credit transfers; (iii) allowing non-bank payment service providers access to all EU payment systems, with appropriate safeguards, and giving them a right to have a bank account; (iv) improving the functioning of open banking, especially as regards the performance of data interfaces, removing obstacles to open banking services and ensuring consumer control over their data access permissions; and (v) further improving consumer information and rights.

The second legislative proposal is a regulation on a framework for financial data access (FIDA). This proposal establishes a framework for responsible access to individual and business customer data across a range of financial services – "open finance". The proposal aims to ensure that all consumers and firms have effective tools to control the use of their financial data.

The European Parliament and the Council of the EU are currently considering the proposals. The legislation is expected to apply 18 months after publication in the OJ, which is not likely to be until 2026/27. European Parliament elections in Q2 2024 may delay the work this year. Please see our **bulletin** for further information.

Instant payments

The proposed Regulation amending the SEPA Migration Regulation and the Cross-Border Payments Regulation (the Instant Payments Regulation) is currently being finalised. The Instant Payments Regulation aims to improve the availability of instant payment options in euro to consumers and businesses in the EU and in EEA countries. Under the provisionally agreed rules, PSPs, such as banks, which provide standard credit transfers in euro, will also be required to offer the service of sending and receiving instant payments in euro. The charges that apply (if any) must not be higher than the charges that apply for standard credit transfers. Payment and e-money institutions (PIEMIs) will also be granted access to payment systems, by changing the Settlement Finality Directive. As such, PIEMIs will be covered by the obligation to offer the service of sending and receiving instant credit transfers, but after a longer transitional period than the traditional banking actors.

The Council of the EU and European Parliament have agreed that the new rules will come into force after a transition period that will be faster in the euro area and longer in the non-euro area, which need more time to adjust. As the text does not appear to be very controversial, the Instant Payments Regulation could apply from the end of this year/2025. For more information, please see "**Paving the way for the future of payments – Instant payments at a glance**".

FinTech/Digital Assets

MiCAR

The European Commission adopted a proposal for a Regulation on markets in cryptoassets (known as MiCAR), in September 2020, as part of its Digital Finance Strategy that included a package of proposed legislative measures to create a framework for the regulation of cryptoassets in the EU. MiCAR came into force on 29 June 2023. It establishes a new EU legal framework for a broad range of cryptoassets that are not covered by existing EU financial services legislation, and introduces specific rules for stablecoins, which are divided into e-money tokens (EMTs) and asset-referenced tokens (ARTs).

MiCAR introduces requirements for cryptoasset issuers and cryptoasset service providers (CASPs) relating to: (i) transparency and disclosure for the issuance, offer to the public and admission to trading of cryptoassets. This includes an obligation on all issuers of cryptoassets that fall within the scope of MiCAR to publish an information document, called a white paper, setting out mandatory disclosures. The white paper must be notified to competent authorities, who may require modifications (although there is no pre-approval requirement before publication). Additional disclosures are required for ARTs and EMTs; (ii) authorisation of CASPs and issuers of ARTs (unless they are already authorised under existing financial services legislation); (iii) supervision of CASPs, issuers of ARTs and issuers of EMTs, including powers for the European Supervisory Authorities to supervise certain "significant" issuers and CASPs; (iv) operation, organisation and governance of CASPs, issuers of ARTs and issuers of EMTs; (v) consumer protection in the issuance, offer to the public and trading, exchange and custody of cryptoassets; (vi) prevention of insider dealing, unlawful disclosure of inside information and market manipulation related to cryptoassets; and (vii) a change in control regime governing the acquisition of interests in CASPs.

Please see the Prudential section for further information on the prudential requirements under MiCAR.

The requirements relating to ARTs and EMTs will apply from 30 June 2024, after a 12-month transitional period. The remaining provisions that apply to CASPs will apply from 30 December 2024. ESMA and the EBA have also been mandated to develop technical standards and guidelines specifying certain provisions under MiCAR and have already launched various consultation packages. ESMA is due to publish its third and final consultation package in Q1 this year.

For more information on MiCAR, please see our bulletins "**MiCAR under the microscope – Part 1: MiCAR is law**", "**MiCAR under the microscope – Part 2: Are you in or out of scope?**", and our "**Shaping the future of MiCAR**" blog post series.

Please see the AML/Financial crime section for information on the recast revised Wire Transfer Regulation.

Digital euro

The digital euro project is the European Central Bank's (ECB) response to the changing landscape of consumer payments, driven by the rise of cryptocurrency, payment fintechs and electronic transactions. A digital euro would be a new form of digital money, issued and supervised by the ECB as a central bank digital currency (CBDC). To advance the development and implementation of this project, on 28 June 2023, the European Commission presented the digital euro package. This legislative package includes a Regulation establishing the legal framework for a possible digital euro. The digital euro would be a supplement to euro cash. It would take the form of a universal means of payment across the euro area, which would hold legal tender status (as euro cash) and be widely accepted as a means of payment. Please see our bulletin **here**.

On 18 October 2023, the ECB decided to move to the next phase of the digital euro project – the preparation phase. The preparation phase began in November 2023 and marked the conclusion of the investigative phase launched in 2021. The preparation phase will initially last two years. It will involve finalising the digital euro rulebook and selecting providers that could develop a digital euro platform and infrastructure. It will also include testing and experimentation to develop a digital euro that meets both the Eurosystem's requirements and user needs, for example in terms of user experience, privacy, financial inclusion and environmental footprint.

After two years, the ECB will decide whether to move to the next stage of preparations, to pave the way for the possible future issuance and roll-out of a digital euro. The launch of the preparation phase is not a decision on whether to issue a digital euro. That decision will only be considered by the ECB once the European Union's legislative process has been completed. The ECB will take into account any adjustments to the design of the digital euro that may become necessary as a result of the legislative deliberations.

Future regulatory framework for stablecoins

The UK government and FCA are looking to introduce a phased approach to reforming the regulatory regime for cryptoassets, meaning a wider range of cryptoassets will be brought within the UK financial services regulatory perimeter. Phase 1 relates to the regulation of fiat-backed stablecoins used as a means of payment.

On 6 November 2023, the FCA published a discussion paper setting out how it might regulate fiat-backed stablecoins as a means of payment. The paper proposes two means by which a fiat-backed stablecoin may access UK payment chains, either (i) via UK-based fiat-backed stablecoin issuers and custodians; or (ii) in the case of stablecoins issued overseas, following approval by a UK based “payment arranger”. Each “gateway” would be facilitated by an extension of the regulatory perimeter. The use of fiat-backed stablecoins in payment chains would be regulated through amendments to the Payment Services Regulations 2017. Activities of issuance and custody of fiat-backed stablecoins where the coin is issued in or from the UK would be brought within the regulatory perimeter of the Financial Services and Markets Act 2000 (FSMA) through the FSMA (Regulated Activities) Order 2001. The UK government has already started to implement this regime through the Financial Services and Markets Act 2023 (FSMA 2023).

FSMA 2023 also provides the Bank of England and Payment Systems Regulator with powers over systemic and recognised digital settlement asset payment systems and service providers, subject to HMT’s recognition and designation. The Bank of England’s discussion paper, also published on 6 November 2023, deals with the specific issue of how systemic payment systems using stablecoins and related service providers should be regulated. At this stage, the Bank of England’s focus is specifically on sterling-denominated payments, because it considers that these are the most likely digital settlement assets to be used widely for payments. Currently, the Bank of England hasn’t identified any existing stablecoins which would be brought within its remit as systemic.

The proposed regulatory regime for systemic stablecoin systems would include oversight of a variety of business models. Whilst the entity providing the payment/transfer function would remain the Bank of England’s “regulatory hook”, the regime could also capture the stablecoin issuer, the custodian and the provider of the “customer interface” (if different legal entities).

The deadline for both the FCA and Bank of England discussion papers is 6 February 2024. Consultation papers from both the Bank of England and the FCA are then expected to be published in H2 2024. The timing of the FCA consultation paper is subject to HMT secondary legislation being laid, which is expected in early 2024. Please see our blog post **here**.

Managing the failure of DSA (including stablecoin) firms

On 30 October 2023, HMT published its response to the consultation on its proposed approach to managing the failure of systemic digital settlement asset (DSA) (including stablecoin) firms, by applying a modified version of the Financial Market Infrastructure Special Administration Regime (FMI SAR). In order to ensure a balance between clarity over how the FMI SAR will operate with respect to systemic DSA firms, whilst ensuring the Bank of England has the tools it needs to respond to the potential failure of a systemic DSA firm as soon as is possible, HMT intends to implement its proposals as consulted on. HMT notes that it may still in due course conduct further work to consider whether a bespoke legal framework is more appropriate.

HMT intends to appoint the FMI SAR, with necessary amendments, as the primary regime for systemic DSA firms which are not banks. It proposes to establish an additional objective for the FMI SAR focused on the return or transfer of customer funds and custody assets and supplementary necessary provisions and will provide the Bank of England with the power to direct administrators as to the prioritisation of objectives. The Bank of England will also be required to consult with the FCA prior to seeking an administration order or directing administrators. To provide further clarity on the operation of the FMI SAR, the UK government then intends to make the requisite insolvency rules. This will cover the detail and mechanisms underpinning how the regime is intended to operate, including such issues as the transfer or return of customer funds and custody assets, administrator processes. The Bank of England will consider whether further guidance on the operation of the FMI SAR is necessary in the context of its finalised going concern regime.

Future financial services regulatory regime for cryptoassets

HMT has published its response to industry feedback following its February 2023 consultation on the future financial services regulatory regime for cryptoassets. The consultation paper set out HMT's initial policy proposals to extend regulation to a broad suite of cryptoasset activities in the UK, including the exchange, investment, custody, and lending of cryptoassets. The consultation paper also proposed regimes for a range of cross-cutting issues, which apply across cryptoasset activities and business models, including market abuse and cryptoasset issuance and disclosures.

In its response, the UK government confirmed its intention to bring these cryptoasset activities into the regulatory perimeter for financial services under phase 2 of its reform. Firms undertaking cryptoasset activities will need to be authorised under a new FSMA-based regime and comply with prudential requirements, data reporting, consumer protection, location policy and operational resilience.

HMT's response covers numerous areas of its original proposals and whilst not indicating any wholesale change of direction, provides valuable clarity on the direction of travel. Key topics in the response include the territorial scope of the regime, clarification of the treatment of certain cryptoassets like Non-Fungible Tokens, and a modified approach towards market abuse obligations on cryptoasset exchanges, acknowledging the potential need for a staggered implementation for cross-venue data sharing obligations. The response also provides an update on the timelines for phase 2 legislation and further information on the future FCA authorisation process for cryptoasset activities, including accelerating its work in relation to the regulatory treatment of staking. HMT will also proceed with an approach that facilitates access to international liquidity pools under specific circumstances. Please see our blog post "HM Treasury consultation responses on the future UK cryptoasset regulatory framework" **here**.

HMT intends to lay secondary legislation in 2024, when Parliamentary time allows, which will be accompanied by FCA publications. However, the wider regime for cryptoassets is not likely to take effect until post-2025.

Please see the Financial promotions and marketing section for the new rules in relation to cryptoasset financial promotions.

Digital pound

With the belief that 'public' money will become increasingly less useful and useable and of shrinking relevance to a large part of the population, HMT and the Bank of England have consulted on a UK retail CBDC. The digital pound would be issued by the Bank of England and could be used by households and businesses for everyday payments in-store and online. If introduced, it would be interchangeable with cash and bank deposits. The consultation paper offers insight into how a digital pound might work. A decision about whether to implement a digital pound will be taken around the middle of the decade and will largely be based on future developments in money and payments. The earliest stage at which the digital pound could be launched would be the second half of the decade. The deadline for comments was 7 June 2023, and HMT and the Bank of England will release a summary of responses in due course. Whilst continuing to consider a Bank of England-issued digital pound, the Bank of England has also encouraged the development of possible private sector alternatives.

FMI sandboxes

Please see the Financial market infrastructure (FMI) Regulation section for information on FMI sandboxes.

Asset management regulation

Cross-border marketing

In December 2023, the European Commission adopted draft implementing and delegated acts relating to the UCITS Directive and AIFMD as regards cross-border marketing. This follows a final report published by ESMA in December 2022 on draft technical standards. The purpose of the ITS and RTS is to facilitate the notification process for cross-border marketing and management activities in relation to UCITS and AIFs.

The EU Council and the European Parliament will now consider the Commission's drafts. If there is no objection, the new law will enter into force 20 days after it is published in the EU Official Journal and apply 30 days later.

MMF policy framework

The money market fund regime is currently the subject of scrutiny. Addressing vulnerabilities in relation to money market funds is a key element of the Financial Stability Board's work programme to enhance the non-bank financial intermediation sector. In July 2023, the European Commission published a report on the adequacy of the EU money market funds regulation from a prudential and economic point of view. Although this identified some shortcomings, the Commission confirmed it does not intend to propose revisions to the regulation for the present time.

ESMA has also published various reports, including a final report on guidelines on stress test scenarios published on 19 December 2023. The guidelines will now be translated, and will become applicable two months after the publication of the translations. Going forward, money market funds and their managers are required to measure the impact of the stress scenarios specified in the guidelines and comply with related reporting requirements.

AIFMD and UCITS Directives

One of the most significant pieces of legislation for fund managers in 2023 was AIFMD II, being the proposal for a new Directive which would amend AIFMD together with making certain changes to the UCITS Directive for alignment and consistency.

AIFMD II seeks to improve the original AIFMD and introduces key changes in relation to: (i) loan-originating AIFs; (ii) liquidity management for open-ended AIFs; (iii) transparency and supervision of AIFMs; (iv) delegation arrangements; and (v) requirements for depositaries.

Of these changes, delegation arrangements in particular attracted industry attention. In the end, these amendments were less impactful than expected, but a critical change is that EU AIFM business will need to be conducted by at least two EU-domiciled natural persons either employed full-time by the EU AIFM or executive board members of the AIFM. A hoped-for change that did not materialise was the depositary passport.

The European Commission published the final compromise text in Q4 2023 and formal approval by the EU Parliament and Council is expected in Q1 2024. Once published in the Official Journal, AIFMD II (being an amending directive) will enter into force 20 days after publication, after which member states will have 24 months to implement the directive into national law.

PRIIPs

In May 2023, the European Commission issued a legislative proposal for a regulation to amend the PRIIPs Regulation as part of the EU Retail Investment Strategy (please see further commentary on this in the Financial Markets section above).

Targeted changes have been proposed, including a new section in a KID titled "How environmentally sustainable is this product?". Clarifications have also been suggested to the scope of the regulation, requirements for revisions of the KID, as well as proposed changes to certain content and format requirements (for example, the addition of a new "Product at a glance" dashboard and removal of the comprehension alert). The proposed changes are with an eye to strengthening retail investor protection and the proposed provision of the KID in electronic format by means of an interactive tool.

The Commission's proposal has been followed by a draft report published in October 2023 by the European Parliament. The report states that over 70% of EU citizens have never invested in a financial product for various reasons, whether they find it too complex or they have concerns about the risks. The report states "we must do everything to encourage citizens to change this", and contains suggested amendments to the proposed amending regulation (for example, deleting the proposed new "at a glance" section in the KID). The European Parliament also plans to continue to further assess the alignment of the new sustainability section with the relevant existing legislation.

Negotiations on possible reforms to the regime are therefore likely to be ongoing within 2024. Assuming an agreement can be reached, any relevant amendments are likely to come into effect in late 2025 or early 2026.

Consumer Duty

The Consumer Duty is a significant regulatory initiative for the FCA, with far reaching implications for relevant firms. The FCA is expected to continue to focus on achieving improved outcomes for consumers in 2024.

The regime first started to come into effect on 31 July 2023. In 2024, the Consumer Duty will start applying to closed products and services from 31 July. The FCA has consistently referred to the importance of firms' ongoing compliance with the new Consumer Duty rules and guidance, and emphasised that it remains a top priority for the FCA.

The FCA is expected to conduct a review in 2024 to assess how well the Duty has been embedded, with a focus on price and value.

Long Term Asset Funds

The UK government has repealed the European Long-Term Investment Fund Regulation (as applicable in the UK post-Brexit), effective 1 January 2024. The FCA has indicated that this will not be replaced, as no ELTIFs have been established in the UK, and the new UK Long Term Asset Fund regime provides an alternative fund structure "better suited to the needs of the UK market".

Overseas Funds Regime

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

The framework for OFR was introduced in 2021, among other things, via changes to FSMA. The FCA has now commenced some of the detailed work required to 'operationalize' the regime, including the issue of a consultation paper in December 2023 (CP23/26). The consultation closes on 12 February 2024 and the FCA intends to publish a policy statement and final Handbook rules in H1 2024.

Fund tokenisation

In November 2023, the industry-led Technology Working Group released an interim report outlining a strategic blueprint for the implementation of fund tokenisation in the UK. This group reports to the Asset Management Task Force formed by the UK government. The overall goal is to give a lift to the UK fund and asset management industry by harnessing the potential of technological advances, including blockchain and distributed ledger technology.

The report recommends a staged approach to fund tokenisation, starting with a baseline model compatible with the existing legal and regulatory framework. Further work on this initiative is expected to continue in 2024.

The FCA has also announced that it is partnering with regulators in other jurisdictions as part of the Monetary Authority of Singapore's "Project Guardian", a collaborative initiative with the financial industry that explores fund and asset tokenisation use cases, and decentralised finance.

PRIIPs

The UK government has deemed the PRIIPs KID regime as not fit for purpose and, as part of the Edinburgh Reforms, proposed to repeal it as a matter of priority.

In November 2023, the UK government published a policy note and near-final statutory instrument containing the Consumer Composite Investments (Designated Activities) Regulations 2024 which will replace the UK PRIIPs regime and provide the FCA with rule-making powers relating to all persons engaged in providing Consumer Composite Investments (CCIs) to UK retail investors.

Much of the detail of the new regime will be contained in the FCA's rulebook (the FCA will consult on their draft rules for CCI disclosures "in due course"), so it is premature for a detailed comparison of the new disclosure framework against the PRIIPs framework, but the expectation is that the new framework will be less prescriptive. At present, it seems not unlikely the instrument scope of the proposed new regime will be substantially similar to the existing regime, but the definition of "manufacturer", in particular, appears to be broader. Subject to transitional provisions, the new UK disclosure requirements will apply to all funds (and other CCIs that are not excluded products) made available to UK retail investors, including UK-authorised funds and recognised overseas funds. HMT intends to legislate during 2024. Again, subject to the transitional provisions, the new rules will commence at the same time the FCA makes new rules, alongside the repeal of the PRIIPs Regulation and other related legislation.

Other initiatives

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

In December 2023, the FCA issued a consultation setting out proposals to enhance the resilience of UK money market funds (CP23/28). The proposals were apparently developed in close consultation with the UK treasury department and the Bank of England, and reflect work by the Financial Stability Board on money market funds as mentioned above. The consultation closes on 8 March 2024, with final rules to follow in due course, although the precise timing is unclear. In parallel, in December 2023, the UK treasury department published a policy note on its proposed new UK money market funds framework, together with a draft SI, the draft Money Market Funds Regulations 2024. This would replace the retained EU law version of the EU regulation on money market funds. Comments can be received until 24 January 2024. The Treasury has indicated that it will set out a timeline once responses have been considered.

In December 2023, the FCA published a consultation on various rule changes (CP23/25). One chapter suggested minor reforms following a discussion paper (DP23/2) published in February 2023 to look at updating and improving the UK regime for asset management. The consultation also noted that, as the FCA works with the UK government on the repeal and replacement of retained EU law, it will consult on other amendments to its rules during 2024.

The changes made by CP23/25 include changes to allow virtual and hybrid general meetings for fund unitholders, allowing a broader range of investments under the UK's QIS regime, changes in relation to notices sent to joint unitholders, and changes in relation to Shariah-compliant funds.

More broadly, the consultation referenced an October 2023 speech by the FCA chair clarifying the regulatory direction of travel:

- proportional regulation, together with ways in which regulation can drive innovation, lies behind much of the FCA's thinking about investment management;
- following the discussion paper mentioned above, it will be pursuing three main priorities for reform: making the regime for alternative fund managers more proportionate; updating the regime for retail funds; and supporting technological innovation; and
- the FCA recognises the role the sector has to play in mobilising domestic savings to fund productive investment in the UK. The FCA is also pursuing reforms to promote the medium to long-term growth of the UK economy.

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