UPCOMING REGULATORY INITIATIVES IMPACTING PRIVATE FUND MANAGERS

Second Edition 2023

Table of Contents

MARKET CONDITIONS REMAIN CHALLENGING ... **1**

1. ESG ... **2**

2. LIBOR AND GLOBAL BENCHMARK REFORM ... **8**

3. EUROPEAN REGULATORY INITIATIVES ... **10**

3.1 AIFMD Marketing/Pre-marketing – Cross-border Distribution of Investment Funds ... 10

3.2 Further AIFMD Developments ... 10

3.3 Capital Markets Union Action Plan ... 12

3.4 CSDR ... 12

3.5 ELTIF Reform ... 14

3.6 EU European Market Infrastructure Regulation (EMIR) ... 15

3.7 MiFID II ... 17

3.8 EU Commission Review of AML Regime ... 18

3.9 EU Benchmarks Regulation ... 20

3.10 EU SFTR ... 21

3.11 Retail Investment Strategy ... 21

3.12 EU PRIIPs Regulation ... 23

3.13 EU Digital Operational Resilience for the Financial Sector (DORA) ... 23

3.14 EU Regulation on Markets in Cryptoassets (MiCA) ... 24

3.15 EU Securitisation Regulation ... 24

4. UK REGULATORY INITIATIVES ... **25**

4.1 Is Brexit done? Not quite… ... 25

4.2 Financial Services Markets Bill 2022-23 ... 26

4.3 The Edinburgh Reforms ... 26

4.4 The Retained EU Law (Revocation and Reform) Bill 2022-23 ... 27

4.5 Proposals for an ‘Overseas Funds Regime’ ... 28

4.6 FCA Future Regime for Asset Managers ... 28

4.7 A New Consumer Duty ... 29

4.8 UK Short Selling Regulation ... 31

4.9 UK EMIR ... 31

4.10 UK SFTR ... 32

4.11 UK PRIIPS ... 32

4.12 UK Benchmarks Regulation (UK BMR) ... 33

4.13 UK Securitisation Regulation ... 33

4.14 Financial Promotions Regime ... 34

4.15 Regulation of Cryptoassets ... 34

4.16 Financial Promotion of Cryptoassets ... 36

4.17 AML5 and Cryptoassets ... 37

4.18 Review of the UK’s AML/CFT Regulatory and Supervisory Regime ... 38

5. U.S. REGULATORY INITIATIVES 38

5.1 SEC Proposes Overhaul of Adviser Custody Rule 38

5.2 SEC Adopts Significant Amendments to Form PF to Enhance Private Fund Reporting 39

5.3 SEC Staff Issues Risk Alert Relating to Marketing Rule Compliance 40

5.4 SEC Staff Issues Risk Alert on Safeguarding Client Information at Branch Offices 40

5.5 SEC Adopts Final Rules to Require the Reporting of Executive Compensation Votes by Institutional Investment Managers 40

5.6 SEC Proposes Rule Regarding Obligations for Advisers that Outsource Key Functions 41

5.7 FinCEN Adopts Final Rule for Beneficial Ownership Reporting Requirements 41

5.8 SEC Proposes Substantial Changes to Private Fund Regulatory Regime 41

5.9 New Short Sale Reporting Scheme 41

5.10 Proposal to Modernise Beneficial Ownership Reporting (Schedules 13D and 13G) 41

5.11 Rules to Address Matters Related to Environmental, Social and Governance (ESG) Factors 42

6. HONG KONG REGULATORY INITIATIVES 42

6.1 Virtual Asset Service Provider Licensing Regime 42

6.2 Retail Security Token Offerings 44

6.3 Virtual Asset Futures Exchange Traded Funds 45

6.4 Management and Disclosure of Climate-related Risks of Fund Managers 45

6.5 Cryptocurrency Recognised as "Property" 46

Upcoming Regulatory Initiatives Impacting Private Fund Managers

INFORMATION CORRECT AS AT 30 JUNE 2023

MARKET CONDITIONS REMAIN CHALLENGING

The slowdown of economic activity, high inflation, the global tightening of financial conditions, the geopolitical environment and the materialisation of peripheral risks linked to leverage and liquidity that characterised the end of 2022 and the beginning of 2023 have continued in the first half of 2023.

Financial conditions globally remain challenging, which is impacting economic activity. The Russian war in Ukraine has not ended and sanctions continue to be imposed on Russia and Belarus, which in turn impacts energy, food and commodities costs.

Bank insolvencies hit the headlines in March 2023, but they have not had the same impact as in 2008. Although recent growth forecasts no longer point to a deep recession and inflation is showing signs of moderation, economic uncertainty remains.

Against this backdrop, the regulatory developments may have slowed somewhat, as the need to react to market developments has taken precedence, but the agenda is still full.

The development of digital finance and the growing investor interest in sustainable finance means that global regulators have a long to-do list to develop and implement a suitable regulatory and supervisory framework to accompany these changes.

ESG remains front and centre of regulatory developments. While in an ideal world, a global financial system would have global consistency, the approach taken in the EU, UK, U.S. and Hong Kong is not identical, creating challenges for firms with global operations.

Digital technology continues to shape the way financial services are provided, with firms across the financial sector being increasingly linked digitally as they transact and communicate electronically. As ESMA[1] has noted, "*This technological innovation challenges existing market practices. It has the potential to disrupt market structures with both positive and negative effects*".[2] Unsurprisingly, regulatory developments in the digital asset space continue and in the EU the MiCA Regulation has been published in the Official Journal of the EU (see 3.14 below) and the Digital Operational Resilience Act, or DORA, is now in force (see 3.13 below). The UK has set out its proposals for this future regime for cryptoassets, albeit not in the form of an on-shored MiCA (see 4.15 below).

In the EU, agreement has been reached on the proposals to amend ELTIF Regulation ((see 3.5 below), while efforts continue to agree on amendments to AIFMD (see 3.2 below). Investor protection remains a key concern for the European Commission (the **EU Commission**), with the publication of the Retail Investment Strategy (see 3.11 below).

With regard to the UK regulatory agenda, the UK is pressing ahead with establishing its own post-Brexit regulatory framework and key pieces of legislation have very recently reached the end of the legislative process (see 4.2 below and 4.4 below).

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[1] European Securities and Markets Authority.

[2] Verena Ross Keynote Speech at ICMA AGM May 2023 here.

There is no doubt that the world is becoming increasingly complex, with new challenges and opportunities developing at speed – and as you will see in the following pages, regulatory initiatives are also increasing as they try to keep pace with developments.

The regulatory agendas in the U.S. and Hong Kong are just as busy.

1. ESG

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

Recent years have seen the advent of the Sustainable Finance Disclosure Regulation[3] (**SFDR**) and the Taxonomy Regulation.[4] These impact "Financial Market Participants" (**FMPs**) (which include alternative investment fund managers (**AIFMs**), UCITS management companies (**UCITS ManCos**) and Portfolio Managers/Advisors), and "Financial Products" (which include alternative investment funds (**AIFs**), UCITS and segregated investment management mandates).

The SFDR, which took effect on 10 March 2021, requires three types of disclosure (some of which are required at the level of the FMP and some of which are required at the level of the Financial Product) – pre-contractual disclosure, website disclosure and periodic reporting. Whilst SFDR is a disclosure regulation, when practically applied it requires FMPs to make significant changes to their pre-March 2021 processes. At the level of the Financial Product, the nature of the disclosures and reporting required depends on whether that Financial Product promotes environmental or social characteristics or invests a proportion of its assets into Sustainable Investments (as defined under SFDR) (Article 8 products), has a sustainable investment objective (Article 9 products), or does not fall into either the Article 8 or Article 9 category of Financial Product (Article 6 products).

The Taxonomy Regulation, which took effect on 1 January 2022, establishes an EU-wide classification system or 'framework' intended to provide businesses and investors with a common language to identify to what degree economic activities can be considered environmentally sustainable. It supplements the SFDR rules by requiring certain additional disclosures by Article 8 and Article 9 products regarding how their investment activities align with specified criteria and standards. For Article 6 products, prescribed language must be included in the relevant offering documentation clarifying that the product does not make Taxonomy-aligned investments.

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

The Taxonomy Regulation has been supplemented by delegated legislation that adds detail to the primary legislation.

The SFDR, as amended by the Taxonomy Regulation, required the European Supervisory Authorities (**ESAs**) to prepare Level 2 Regulatory Technical Standards (**RTS**). The RTS have already been revised twice since they were published in the Official Journal of the EU (**OJ**) on 25 July 2022. The most recent amendments[5] detail the information that should be provided in pre-contractual documents, on websites and in periodic reports about the exposure of Financial Products to investments in fossil gas and nuclear energy activities.[6]

[3] Regulation (EU) 2019/2088.

[4] Regulation (EU) 2020/852.

[5] The delegated regulation and annexes were published in the OJ on 17 February 2023 and are available here.

[6] The delegated regulation and annexes were published in the OJ on 17 February 2023 and are available here.

FMPs required to consider principal adverse impacts (**PAI**) of investment decisions on sustainability factors[7] must have published their first reports on those impacts by 30 June 2023 covering the period 1 January 2022 to 31 December 2022.

On 6 May 2022 the ESAs announced that they had received a letter from the EU Commission (dated 11 April 2022) mandating them to undertake a review of the RTS including regarding PAI indicators and transparency of Financial Products.[8] The initial deadline of April 2023 has already been pushed back to the end of October 2023.

On 12 April 2023, the ESAs published a joint consultation paper[9] on proposed amendments to the RTS on content and presentation of PAI and financial product disclosures in the RTS. The purpose of the consultation is to broaden the disclosure framework, address some technical issues, and propose amendments to pre-contractual, periodic documents or website disclosures for Financial Products, in order to include greenhouse gas emissions reduction targets, including intermediary targets and milestones and actions taken. The ESA's mandate is limited to certain specific areas and not a review of all aspects of the RTS.

The consultation closes on 4 July 2023, after which the ESAs will prepare a final report for the EU Commission. For more information, see our OnPoint "Is the market ready for SFDR 1.5? ESAs propose changes to SFDR RTS", available here.

As noted above, the Taxonomy Regulation is supplemented by delegated legislation. The EU Taxonomy Climate Delegated Act (Commission Delegated Regulation (EU) 2021/2139),[10] published in the OJ on 21 December 2021 and effective since 1 January 2022, contains the first two sets of TSC for determining which economic activities can qualify as contributing substantially to climate change mitigation or climate change adaptation, including criteria for determining whether that economic activity causes "no significant harm" to any of the other environmental objectives set out in Article 9 of the Taxonomy Regulation. The Taxonomy Disclosures Delegated Regulation (Commission Delegated Regulation (EU) 2021/2178),[11] published in the OJ on 10 December 2021, specifies the content and presentation of information to be disclosed by non-financial undertakings, asset managers, credit institutions, investment firms, and insurance and reinsurance undertakings as well as common rules relating to key performance indicators. It entered into force on 30 December 2021 and has applied since 1 January 2022 with a phased application.

On 5 April 2023, the EU Commission published a consultation[12] on a draft Delegated Act (Taxonomy Environmental Delegated Act) containing proposals for the remaining four sets of TSC for determining the conditions under which 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 other environmental objective. The consultation proposed targeted amendments to EU Taxonomy Climate Delegated Act, to include certain additional activities which can be considered as contributing to the environmental objectives of climate change mitigation and adaptation. The consultation also proposed amendments to the Taxonomy Disclosures Delegated Regulation to ensure that its disclosure requirements are consistent with the Taxonomy Environmental Delegated Act and to correct a small number of mistakes and inconsistencies. The consultation closed on 3 May 2023. As part of the Sustainable Finance Package[13] published by the EU Commission on 13 June 2023, the EU Commission announced that it had approved in principle the two Delegated Regulations relating to the EU Taxonomy Regulation. The next stage in the legislative process is for

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

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

[9] The April 2023 consultation paper on the RTS is available here.

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

[11] The Taxonomy Disclosures Delegated Regulation is available here.

[12] The April 2023 consultation is available here.

[13] The Sustainable Finance Package is available here.

them to be translated and formally adopted, then transmitted to the European Parliament and the Council for a four-month period of scrutiny (which can be extended by two months).

As can be seen, the interplay between the SFDR, the Taxonomy Regulation and various supporting legislation is both complex and extensive. The EU Commission has published a usability guide[14] that aims to clarify and simplify the links between the key concepts and identify any gaps that might prevent stakeholders from complying with their obligations. As a further aid the EU Commission has also developed a Taxonomy Navigator,[15] that it describes as "*a user-friendly website that offers a series of online tools to help users better understand the EU Taxonomy in a simple and practical manner, ultimately facilitating its implementation and supporting companies in their reporting obligations*".

The EU Commission was due to publish a report on the application of the Taxonomy Regulation by 13 July 2022, and then every three years (under Article 26(1) of the Taxonomy Regulation). The report has not yet been published.

In terms of other developments, in a speech[16] given on 4 May 2023, ESMA remarked that the SFDR framework remains complex and difficult to navigate for investors, and also highlighted "*a clear need to step up our efforts to combat the risk of greenwashing*". Greenwashing remains a focus for the EU co-legislators.[17] ESMA believes that some criteria should be required when naming funds that claim to have sustainability characteristics or goals. ESMA is currently assessing and analysing the responses to its consultation[18] on fund names that closed on 20 February 2023. The consultation included draft guidelines on the use of ESG or sustainability-related terms in fund names, with ESMA seeking feedback on the introduction of quantitative thresholds for the minimum proportion of investments sufficient to support the use of ESG or sustainability-related terms in a fund's name. ESMA is proposing: (i) a quantitative threshold (80%) for the use of ESG-related words; (ii) an additional threshold for the use of 'sustainable' or any sustainability-related term, where a minimum of 50% of the fund's investments (not 50% of the 80% quantitative threshold referenced in (i) above) would need to be sustainable investments as defined under SFDR; (iii) application of minimum safeguards to all investments for funds using such terms (exclusion criteria); and (iv) additional considerations for specific types of funds (index and impact funds). ESMA proposes that the draft guidelines would apply three months after the publication of their translation on the ESMA website. Furthermore, a transitional period of six months is suggested for those funds launched prior the application date, in order to comply with the Guidelines.

Additional ESG-related regulatory developments include the EU Commission amending MiFID II (product governance/organisational requirements), the UCITS Directive and the AIFMD. These amendments were published in the OJ on 2 August 2021 and entered into force on 22 August 2021. The amendments to the AIFMD[19]

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[14] The Guide is available here.

[15] The Taxonomy Navigator is available here.

[16] The ESMA speech is available here.

[17] In May 2022, the EU Commission issued a "Request for input related to greenwashing risks and the supervision of sustainable finance policies" to the ESAs. On 1 June 2023, the ESAs each published various progress reports on greenwashing as a stock take of the current situation, providing initial findings, which will form the basis for a Final Report that is due in May 2024. On 31 May ESMA published a progress report on Greenwashing (available here).

[18] The consultation is available here.

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

and UCITS Directive[20] have applied since 1 August 2022, the MiFID II organisational requirements[21] since 2 August 2022, and the MiFID II product governance requirements[22] since 22 November 2022.[23]

On 16 June 2023, ESMA published a call for evidence (**CfE**) on the integration of sustainability preferences in the suitability assessment and product governance arrangements under the MiFID II Directive.

The aim of the CfE is to "*gather evidence on the evolution of the market and on how firms are applying the legal requirements*". ESMA expressly states that the CfE is not intended as a new consultation on the content of the suitability guidelines or of the guidelines on product governance, revised versions of which were published in September 2022 and March 2023 respectively (see 3.7 for details) nor is it aimed at any specific changes to the guidelines but is instead intended, amongst other things, to improve ESMA's understanding of how the MiFID II requirements are being applied by firms across the EU and the challenges firms are facing in their application.

The changes to the MiFID II product governance requirements have led to the development of the European ESG Template (**EET**) by FinDatEx, the same industry body that maintains the European MiFID Template. Many FMPs are now required to complete the EET by their distributors, so those distributors who are regulated under MiFID II can meet the new sustainability-related requirements.

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

The CSRD[24] was published in the OJ on 16 December 2022 and entered into force on 5 January 2023. Member States have until 6 July 2024 to bring into force the laws, regulations and administrative provisions necessary to comply with Articles 1 to 3 of CSRD. The rules will start to apply on a phased basis between 2024 and 2028: (i) from 1 January 2024 for large public-interest companies (with over 500 employees) already subject to the NFRD, with reports due in 2025; (ii) from 1 January 2025 for large companies that are not presently subject to the NFRD (with more than 250 employees and/or €40 million in turnover and/or €20 million in total assets), with reports due in 2026; and (iii) from 1 January 2026 for listed SMEs and other undertakings, with reports due in 2027. SMEs can opt-out until 2028.

The EU Commission has previously highlighted concerns with regards to ESG ratings, noting that they suffer from a lack of transparency regarding their characteristics, methodologies and data sources and how ESG rating providers operate. As a consequence, confidence in ratings is being undermined. As part of the June 2023 Sustainable Finance Package the EU Commission set out a proposal for a Regulation on ESG ratings.[25] Amongst other things, the proposed Regulation: (i) specifies that ESG rating providers based in the EU must be authorised

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

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

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

[23] For more information, please see our OnPoint "MiFID II ESG product governance amendments in force from 22 November 2022", available here.

[24] CSRD (Directive (EU) 2022/2464) is available here.

[25] The proposal is available here.

by ESMA and, following authorisation, subject to ongoing supervision by ESMA; (ii) includes specific requirements on ESG rating providers with regards to their internal organisation, disclosures concerning methodologies and mechanisms intended to address conflicts of interest and (iii) includes mechanisms to permit third country ESG rating providers to provide ESG ratings in the EU in certain circumstances. ESMA would maintain a register of all authorised ESG rating providers.

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

On 23 February 2022, the EU Commission adopted a proposal for a Directive on corporate sustainability due diligence (**CSDDD**).[26] Companies within scope of the CSDDD are those based in the EU that meet certain prescribed thresholds as well as companies doing a certain amount of business in the EU. The impact on those in scope would be significant, as under the proposal they would have to ensure human rights and environmental due diligence is engrained in their core business activities. In-scope entities also need to identify actual or potential adverse impacts, which arise from a company's own operations, those of its subsidiaries and from established business relationships in its value chains. On 30 November 2022, the Council adopted its negotiating position,[27] and on 1 June 2023, the European Parliament announced it had adopted its opinion on the CSDDD.[28]

Now that the European Parliament has adopted its position, negotiations with the Council on the final text of the legislation can begin. In terms of key points as the Trilogues commence, the EU Commission and the European Parliament's positions are somewhat aligned with regard to what CSDDD means for financial services. The EU Commission proposes that regulated financial undertakings are in scope – which would include MiFID investment firms, AIFMs, UCITS ManCos, UCITS and AIFs managed by AIFMs. The European Parliament proposes amending the EU Commission's proposal to delete AIFs and UCITS, but bringing institutional investors in scope. The Council proposes a narrower approach than the European Parliament and Commission, focusing on a limited chain of activities as opposed to the whole chain and leaving the decision of whether or not to include the provision of financial services by regulated financial undertakings to each Member State when transposing the CSDDD.

Q&As: The various EU institutions and individual regulators have published several documents that are aimed at helping FMPs understand the various pieces of EU ESG-related regulation. On 18 May 2023, the ESAs published a set of consolidated Q&As[29] on SFDR and on the RTS. On 16 June 2023, the EU Commission published an FAQ that aims to provide some clarifications on how to approach the requirements for compliance with minimum safeguards under the Article 18 of the Taxonomy Regulation among other provisions.[30] In addition, Luxembourg's supervisory authority, the Commission de Surveillance du Secteur Financier (**CSSF**) published an FAQ that seeks to clarify certain items under SFDR in December 2022,[31] and which have subsequently been updated,[32] most recently on 5 May 2023.

UK ESG Regulation

The UK's approach to regulating ESG is different from the EU.

The UK's legislative proposals initially focused on the recommendations of the Task Force for Climate-related Financial Disclosures (**TCFD**) that aims to price climate-related risks and opportunities into financial decision-making. The TCFD recommendations have been developed for use globally, and the UK was one of the first

[26] The directive is available here.
[27] The Council negotiation position agreed on 30 November 2022 is available here.
[28] The EU Parliament's position on CSDDD is available here.
[29] The Consolidated SFDR Q&A are available here.
[30] The EU Commission Notice containing the FAQ is available here.
[31] See our OnPoint "Luxembourg's CSSF SFDR Guidance – what you need to know" for more information.
[32] The CSSF SFDR Guidance is available here.

countries to endorse the TCFD recommendations, with the UK's 2019 Green Finance Strategy proposing that all UK-listed issuers and large asset owners would be disclosing in accordance with TCFD by 2022.

In December 2021, the Financial Conduct Authority (**FCA**) published its Policy Statement "Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers"[33] (**PS 21/24**) following from its earlier consultation paper (**CP21/17**). PS 21/24 set out rules that applied to in-scope UK asset managers with assets under management (**AUM**) of £50 billion or more from January 2022 and to smaller firms above the £5 billion exemption threshold from January 2023, with firm and product-level disclosure requirements applying from 30 June 2023. PS 21/24 also contained the FCA's final rules and guidance in a new Environmental, Social and Governance (**ESG**) Sourcebook that will be expanded to cover additional sustainability topics over time. For more information, see our OnPoint "FCA Policy Statement on enhancing climate-related disclosures by UK asset managers."

In November 2021, the FCA issued a discussion paper on sustainability disclosure requirements (**SDR**) and investment labels (**DP 21/4**),[34] and in October 2022 published a Consultation Paper on Sustainability Disclosure Requirements (**SDR**) and investment labels (**CP 22/20**).[35] CP 22/20 sets out the FCA's proposed sustainability-related disclosure rules for UK funds, portfolio management mandates and the UK firms managing such products. The proposed regime does not apply to investment managers that are not FCA regulated, nor does it apply to non-UK funds, although the FCA intends to follow with a separate consultation on how the proposals in CP 22/20 may be applied in respect of non-UK funds. The proposals set out in CP 22/20 cover: (i) sustainable investment labels; (ii) consumer facing disclosures; (iii) detailed disclosures targeted at a wider audience (institutional investors and consumers seeking more information); (iv) naming and marketing rules; (v) requirements for distributors (such as investment platforms); and (vi) a general anti-greenwashing rule. The FCA originally intended publishing final rules by the end of the first half of 2023 and proposed that the labelling, naming and marketing, and initial disclosure requirements under the regime would not come into effect until at least 30 June 2024 (that is, one year after the FCA intends to publish its final rules). However on 29 March 2023 the FCA announced[36] that, due to the significant response to CP 22/20, it intends to publish the Policy Statement in Q3 2023, and the proposed effective dates will be adjusted accordingly. The FCA's proposals relating to its general 'anti-greenwashing' rule reiterating requirements for all regulated firms that sustainability-related claims must be clear, fair and not misleading are due to come into effect immediately on publishing its policy statement.

For full details, please see our OnPoint "CP22/20: Further leaves unfurl on the tree of the UK ESG regime", available here.

The Edinburgh Reforms (see 4.3 below) also included proposals for sustainable finance regulation similar to the EU proposals. On 30 March 2023, the government published an updated Green Finance Strategy.[37] As part of that strategy, also on 30 March 2023, the government launched a consultation on a future regulatory regime for ESG ratings providers, the aim being to improve transparency and promote good conduct in the ESG ratings market. [38] There is now a statement on the FCA's website that if a firm seeking FCA authorisation will offer ESG-related advice, products or services as a material part of its business model, it must detail the ESG goals for its products and services and how it will explain these to investors.

Further details of UK developments are discussed in the Summer 2022 edition, the Autumn 2022 edition and the First Edition 2023 of the Horizon Scanner.

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[33] PS 21/14 is available here.
[34] DP 21/4 is available here.
[35] CP 22/20 is available here.
[36] The FCA's announcement is available here.
[37] The 2023 Green Finance Strategy is available here.
[38] The consultation on the future regulatory regime for ESG rating providers is available here.

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

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

2. LIBOR AND GLOBAL BENCHMARK REFORM

On 1 January 2022, the publication of most LIBOR tenors ended. On 30 June 2023, publication of the five tenors of USD LIBOR that had survived that cessation also ended, with 30 June marking the final publication of any tenors of LIBOR on a representative basis. From 1 July 2023 "synthetic versions" of the one-, three- and six-month LIBOR settings will be available (as discussed in more detail below). Publication of overnight and 12-month USD LIBOR permanently ended on 30 June 2023.

Since 2022 there has been an increased focus on the alternative largely risk-free rates (**RFRs**) that are the established replacements for each of the LIBOR family of currencies: SONIA (GBP), SOFR (USD), SARON (CHF), €STR (EURO) and TONA (JPY).

Prompted originally by the seminal 2017 speech given by Andrew Bailey - then governor of the Bank of England (**BoE**) - that triggered the end of LIBOR, significant work across different financial products and markets has been undertaken to manage the transition away from other benchmarks, including other inter-bank offered rates (**IBOR**s) to more robust alternatives.

On 27 April 2023, the Financial Stability Board (**FSB**) published a statement[39] to encourage final preparations for the USD LIBOR transition, emphasising the ongoing importance of market participants choosing to use robust reference rates in their contracts, it being essential that the financial system is anchored in these robust reference rates that reflect deep, credible, and liquid underlying markets.

Set out below are key takeaways with respect to the current UK, U.S. and EU previsions. Previous editions of the Horizon Scanner have covered developments relating to LIBOR, the transition to the RFRs and global benchmark reform in detail.

UK Developments Including Synthetic LIBOR

The Financial Services Act 2021[40] (**FS Act**) gave the FCA new and enhanced powers to manage the wind down of a critical benchmark (such as LIBOR). The provisions relating to UK Benchmarks Regulation (**UK BMR**) entered into force on 1 July 2021. The FCA has already exercised its power to retain LIBOR on a changed methodology for certain GBP LIBOR, JPY LIBOR and USD LIBOR settings that have been deemed unrepresentative. That new rate (i.e., LIBOR in name, but calculated on a changed methodology) is referred to as 'synthetic LIBOR'. The purpose of 'synthetic LIBOR' is to help 'tough legacy' contracts where LIBOR transition is not possible or cannot easily be achieved. It is not for use in new contracts.

Publication of the six "synthetic" Japanese yen LIBOR settings ended on 31 December 2022. Publication of one- and six-month synthetic GBP sterling LIBOR ceased after final publication on 31 March 2023. Three-month synthetic GBP sterling LIBOR will cease on the last business day of March 2024.[41]

Although overnight and one-, three-, six- and 12-month tenors of USD LIBOR only officially stopped being published on 30 June 2023, the FCA, exercising powers given to it under the FS Act, has restricted UK-supervised entities from using USD LIBOR except in very limited cases since the start of 2022. On 3 April 2023, the FCA announced its decision to require LIBOR's administrator, ICE Benchmark Administration Limited (**IBA**), to continue the publication of the one, three and six-month USD LIBOR settings under a 'synthetic' methodology until 30

[39] The FSB statement is available here.

[40] For more detail on the FS Act, see the Summer 2022 edition and the Autumn 2022 edition of the Horizon Scanner.

[41] Due to the Easter bank holiday, this will be Thursday 28 March 2024.

September 2024. After this, publication of USD LIBOR will end permanently. Overnight and 12-month USD LIBOR settings will not be published using a synthetic methodology.

On 12 April 2023, the BoE and the FCA both published identical press releases[42] in which they encourage market participants to take the following actions:

- Actively transition USD LIBOR contracts ahead of the cessation of the USD LIBOR panel on 30 June 2023.
- Ensure they are ready to implement USD LIBOR fallbacks, including planned central counterparty (**CCP**) conversion events and operationalisation of the ISDA 2020 IBOR Fallbacks Protocol. The proposed timings of CCP conversion events are set out in a table within the press releases.
- Ensure they transition to the most robust RFRs for the relevant currency. The recommended alternative RFR to USD LIBOR is SOFR.
- Continue actively to transition any remaining legacy contracts from synthetic GBP LIBOR to SONIA.

The FCA makes it clear in the press release that synthetic LIBOR is a temporary bridge to the RFRs (i.e. SOFR for USD LIBOR) and, therefore, wherever practicable, active transition of legacy USD LIBOR contracts remains the best way for market participants to retain control and certainty over their existing contracts. This is in line with recommendations from U.S. authorities and the U.S.'s Alternative Reference Rates Committee[43] (**ARRC**), which have highlighted the importance of acting now to remediate contracts ahead of key dates.

On 31 May 2023, the FCA issued a further LIBOR-related press release[44] reminding market participants they must be prepared for the end dates of both LIBOR and synthetic LIBOR settings, and that all new use of the remaining USD LIBOR settings will be prohibited. The FCA also published a feedback statement to its November 2022 consultation on its proposals for a synthetic USD LIBOR and two technical notices under the UK BMR as part of the implementation of the FCA's decisions. Further technical publications shortly after midnight on 1 July 2023 will complete the implementation.

U.S. Developments

Similar to the FCA, with only 30 days remaining before the cessation of the remaining tenors of USD LIBOR, on 31 May 2023, the ARRC issued a statement[45] continuing to urge market participants with LIBOR exposures to complete their transition efforts now, and to draw upon the numerous resources and tools that have been made available over the past several years to facilitate this.

For contracts in scope of the U.S. "statutory solution" - namely U.S. law-governed tough legacy contracts that reference overnight, one-, three-, six- or 12 month tenors of USD LIBOR (see previous versions of the Horizon Scanner for more detail) - from 30 June 2023 the LIBOR Act will work to replace USD LIBOR with the identified SOFR based benchmark rates.

EU Developments

There have not been any 2023 general public statements from ESMA with respect to the end of LIBOR on 30 June 2023. It remains the case that the only statutory replacement rates designated pursuant to the EU statutory solution are in respect of CHF LIBOR and EONIA, to SARON and €STR respectively.

[42] The press release is available here.
[43] The ARRC is a group of private-market participants convened by the Federal Reserve Board and Federal Reserve Bank of New York in cooperation with other U.S. agencies that was convened in 2014 to identify risk-free alternative reference rates for USD LIBOR, identify best practices for contract robustness, and create an implementation plan with metrics of success and a timeline to support an orderly adoption.
[44] The press release is available here.
[45] The ARRC's statement is available here.

The publication of EURIBOR continues, using the hybrid methodology introduced in 2019. In May 2023 the Euro RFR Working Group published guidance[46] for corporate lending products for implementing the recommendations on EURIBOR fallback trigger events and €STR-based EURIBOR fallbacks. While there is currently no plan to discontinue EURIBOR, the guidance reiterates the importance of adopting robust fallbacks to EURIBOR to avoid any future potential operational and market disruption risks. The guidance notes that replacement of screen rate language and costs of funds are not workable permanent fallbacks.

Further details of U.S. and EU Developments are available in the First Edition 2023 of the Horizon Scanner.

3. EUROPEAN REGULATORY INITIATIVES

3.1 AIFMD Marketing/Pre-marketing – Cross-border Distribution of Investment Funds

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

The changes were made by Regulation (EU) 2019/1156 and Directive (EU) 2019/1160 and are commonly referred to as the CBDF framework, which forms part of the EU's capital markets union initiative. (See 3.3 below). ESMA guidelines[47] for funds' marketing communications under Article 4 of the Regulation on cross-border distribution of funds were published on 2 August 2021 and have applied since 2 February 2022. They specify the requirements for marketing communications promoting UCITS and AIFs (including EuSEFs, EuVECAs and ELTIFs).

Article 18 of the Regulation requires the EU Commission to produce a report on reverse solicitation and demand on the own initiative of an investor, specifying the extent of that form of subscription to funds, its geographical distribution and its impact on the passporting regime by 2 August 2021. However, the August 2021 deadline was not met and, at the time of writing the report has not been published.

By 2 August 2023, the EU Commission has to present a report about the merits of harmonising the provisions applicable to UCITS management companies testing investor appetite for a particular investment idea or investment strategy.

There have been no recent significant developments. For more information, see the Summer 2022 edition of the Horizon Scanner.

3.2 Further AIFMD Developments

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

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

The Council adopted its general approach on 17 June 2022.[48] The European Parliament finalised its position on 24 January 2023. Trilogue discussions between the EU Commission, European Parliament and Council commenced on 8 March 2023. On 28 March 2023, the Council of the EU published an information note containing a table comparing the negotiating positions taken by the co-legislators on the proposed amendments to AIFMD.

[46] The guidance is available here.

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

[48] The Council position is available here.

The co-legislators intended to reach agreement under the Swedish Presidency of the Council which ends on 30 June 2023, with publication of the final directive in the OJ in late 2023. We discuss recent developments in our OnPoint "AIFMD 2.0 – The Negotiations Begin", available here. The final Trilogue meeting under the Swedish Presidency had been scheduled for 26 June, but it was announced on 23 June that the meeting would not take place due to a lack of agreement on outstanding issues. The file will now pass to the Spanish Presidency of the Council. For more information, see our OnPoint "AIFMD 2.0 update – no agreement reached under the Swedish Presidency of the Council of the EU", available here.

Once the amending directive is agreed, Member States will have 24 months to implement the changes. This means the amended AIFMD is likely to apply from Q1 2026 at the earliest.

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

Notifications for cross-border marketing and cross-border management of AIFs and UCITS: The UCITS Directive and the AIFMD empower ESMA to develop draft RTS and draft Implementing Technical Standards (**ITS**) to specify the information to be provided, as well as the content and format of notification letters to be submitted by UCITS ManCos and AIFMs to the national competent authorities (**NCAs**) to undertake cross-border marketing or cross-border management activities and to provide services in host Member States, as well as the procedure for the communication of the notification file by the relevant home NCA to the host NCAs of the Member States where these activities are envisaged.

Following an earlier consultation, on 21 December 2022, ESMA published a final report[49] including all the relevant RTS and ITS developed under the relevant provisions of the UCITS Directive and AIFMD.

ESMA has submitted the RTS and ITS to the EU Commission for adoption within three months in the form respectively of a Commission Delegated Regulation and a Commission Implementing Regulation. At the time of writing the final RTS and ITS have not been adopted. Following their adoption, the final RTS and ITS will then be subject to the non-objection of the European Parliament and of the Council. Once adopted the RTS and ITS will be binding in their entirety, directly applicable in all Member States and will apply from three months after publication in the OJ.

ESMA Opinion on undue costs of UCITS and AIFs: Linked to the Retail Investment Strategy (see 3.11 below) on 17 May 2023, ESMA published an opinion[50] suggesting clarifications on the legislative proposals under the UCITS Directive and AIFMD relating to "undue costs". The opinion follows ESMA's Common Supervisory Action (**CSA**) with NCAs on the supervision of costs and fees of UCITS across the EU/EEA, launched in January 2021.The CSA found divergent practices as to what constituted undue costs and recommended further legislative specification to provide more convergence and a stronger legal basis for NCAs to take supervisory and enforcement action.

ESMA final report on asset valuation rules under UCITS Directive and AIFMD: On 24 May 2023, ESMA published a final report[51] on its CSA with NCAs on supervision of the asset valuation rules under the UCITS Directive and AIFMD. ESMA identified room for improvement in the following areas:

- The appropriateness of valuation policies and procedures: a lack of documented and established policies and procedures, as well as a lack of clear definition of the valuation model to be applied.
- Valuation under stressed market conditions: valuation policies and procedures that did not distinguish between normal and stressed market conditions, and a lack of systematic incorporation of the outcome of liquidity stress testing, particularly for less-liquid assets.

[49] ESMA's final report is available here.

[50] The ESMA opinion is available here.

[51] The final report is available here.

- Independence of the valuation function and use of third-party valuers: issues relating to a lack of independence, particularly from portfolio management, with smaller managers over-relying on third-party data providers.
- Early detection mechanisms for valuation errors and compensation to investors: remedial procedures to ensure early detection of valuation errors and full investor compensation were not always appropriately formalised.
- Focus on private equity (**PE**) and real estate (**RE**) assets: issues arose in the alignment between the net asset value (NAV) calculation, the asset valuation frequency and the availability of up-to-date data not only for PE funds, but for all funds invested in less liquid assets and for funds offering daily redemptions, such as some types of RE funds.

ESMA advises that NCAs' supervision address the deficiencies identified in the CSA and use enforcement where appropriate. ESMA also noted that it is important for NCAs to keep paying close attention to potential valuation issues arising from less liquid assets. ESMA states that it will facilitate discussions among NCAs on asset valuation to ensure that market participants and NCAs are better prepared for valuation-related challenges in future periods of stress.

Questions and Answers: On 14 June 2023, ESMA published an updated version of its Q&A on AIFMD.

On 14 June 2023, ESMA also published an updated version of its Q&A on the application of the UCITS Directive.

3.3 Capital Markets Union Action Plan

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

3.4 CSDR

The EU has adopted a settlement discipline regime (the **SDR**) under the European Central Securities Depositories Regulation (**CSDR**). Originally the SDR was due to take effect in its entirety on 1 February 2022.[52] Whilst certain requirements of the SDR did take effect on that date, principally the application of cash penalties and settlement fails reporting requirements, after widespread calls for delay the mandatory buy-in (**MBI**) regime did not go live. Its implementation has been officially delayed and the MBI will not take effect until 2 November 2025.[53]

The SDR aims to reduce the number of settlement fails at central security depositories (**CSDs**) operating securities settlement systems across the EU, such as Euroclear and Clearstream. The CSDR SDR is agnostic as to the location of the counterparties to a trade, so long as the trade settles at a relevant CSD and relates to an in-scope instrument. The SDR has two main elements: measures to prevent settlement fails (Article 6 of CSDR), and measures to address settlement fails (Article 7 of CSDR). The SDR measures include new rules for trade allocation and confirmation processing; cash penalties for transactions that do not settle or that are not matched; and the MBI requirements.

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[52] The UK government announced in June 2020 that it would not be implementing the settlement discipline regime pursuant to UK CSDR following Brexit, meaning that UK securities settlement systems are not subject to a new SDR.

[53] The delegated regulation amending the RTS to delay the application on the MBI regime is available here.

CSDR REFIT: On 16 March 2022, the EU Commission published a legislative proposal[54] for amending the CSDR as regards settlement discipline, cross-border provision of services, supervisory cooperation, provision of banking-type ancillary services and requirements for third-country central securities depositories (**CSDR REFIT Proposal**).

For MBI, the CSDR REFIT Proposal introduces a 'two-step approach' under which MBI would only apply by way of an EU Commission-delegated act if one of a series of conditions is satisfied, one of which is the failure of the cash penalties regime to improve settlement fails. Other proposals relate to passporting and measures for improving cooperation between supervisory authorities, and for oversight of third-country CSDs.

Since the EU Commission's March 2022 publication, there have been notable developments including the European Parliament's ECON announcing in a press release[55] of 1 March 2023 that it had adopted the report and highlighting a number of changes it intended to make. The press release was followed, on 8 March 2023, by the ECON's publication of the text of its report[56] (dated 6 March). The final ECON report retains MBI but it is also clear in the recitals that MBI should only be possible once certain additional conditions are met; namely where the application of cash penalties has not resulted in a long-term continuous reduction or in maintaining a sustainable reduced level of settlement fails in the EU and where the level of settlement fails in the EU has, or is likely to have, a negative effect on the financial stability of the EU.

On 20 December 2022, the Council announced[57] it had agreed its general approach on the CSDR REFIT Proposal, and it also published the text[58] of the general approach. The Council's proposal is to further streamline the rules on the MBI regime, proposing that where a transaction has failed to settle at the end of a prescribed period, the buyer of the securities could be forced to repurchase them elsewhere. The failing party would then be required to meet any price differential between the original and new transaction and all costs of the mandatory buy-in. MBI would be a new measure of last resort, to be activated only in the case where the level of settlement fails would be substantial in the EU. The Council's proposal also includes provisions on enabling CSDs' access to banking-type ancillary services from other duly authorised CSDs, so as to facilitate settlement in non-domestic currencies. Furthermore, it also lays down rules ensuring that authorities in the EU have adequate powers and information to monitor risks in relation to both EU and third-country CSDs, including by enhancing their supervisory cooperation.

Following the final ECON report and the Council's agreement on its negotiating position, Trilogue negotiations between the Council and European Parliament commenced on 18 April 2023. Significantly, on 27 June 2023 the Council published a press release[59] announcing it had reached political agreement with the European Parliament on the CSDR REFIT Proposal.

The press release highlights the following key elements of the provisional agreement: the passporting rules will be clarified and simplified, reducing the barriers to cross-border settlement and easing CSD's administrative and financial burdens, supervision of CSDs will be more effective by improving cooperation among supervisors and giving them access to better information about the activities of non-EU CSDs operating in the EU and certain elements of the SDR will be amended to improve efficiency, including the preconditions to applying MBIs. The agreed text also includes provisions adjusting the conditions under which CSDs can access banking-type services, including through other CSDs. For MBI it is specifically stated that MBI will only be introduced as a measure of last resort, where the rate of EU settlement fails is not improving and is presenting a threat to financial stability.

The provisional agreement needs to be confirmed by the Council and the European Parliament before it can be formally adopted and the final CSDR REFIT Regulation will enter into force following publication in the OJ.

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[54] The CSDR REFIT Proposal is available here.
[55] The ECON's press release is available here.
[56] The ECON's report is available here.
[57] The announcement was made via a press release, available here.
[58] The text of the Council general approach is available here.
[59] See here for the full press release.

In a recent speech delivered by Verena Ross at an industry conference[60], ESMA's intention in 2024 to publish a report on settlement efficiency in the EU was highlighted. Notably the speech also included references to the link between settlement efficiency and reduced settlement cycles and discussions around the potential of a move to T+1 in the EU, given the planned move in the U.S. in May 2024.

Amendments to RTS relating to the penalty mechanism for settlement fails relating to cleared transactions submitted by CCPs for settlement: Following ESMA's consultation and subsequent November 2022 final report[61] relating to Article 19 of the RTS on settlement discipline set out in Commission Delegated Regulation (EU) 2018/1229, which supplements the CSDR, in April 2023 the EU Commission adopted a Delegated Regulation[62] amending Delegated Regulation (EU) 2018/1229. The delegated regulation removes the special collection and distribution process under Article 19 and puts CSDs in charge of the entire process of collection and distribution of all penalties according to Articles 16, 17 and 18 of CSDR.

Questions and Answers: On 13 March 2023, ESMA published an updated version of its CSDR Q&As.[63]

ECSDA – CSDR Settlement fails penalties framework: On 28 April 2023 ECSDA issued an update to the ECSDA CSDR settlement fails penalties framework.

3.5 ELTIF Reform

Following its consultation on the review of the European Long-term Investment Fund (**ELTIF**) Regulation in October 2020, the EU Commission published its proposals for reform of the ELTIF Regulation[64] on 25 November 2021. An EU Commission consultation on the proposals was open for feedback until 21 March 2022. For full details of ELTIF proposals for reform, see the Spring 2022 edition of the Horizon Scanner.

The Trilogue discussions took place over the summer, and on 12 January 2023, as part of the ongoing European legislative process, the European Parliament's ECON approved the text of the regulation amending the ELTIF Regulation (**ELTIF 2.0**). On 20 March 2023, ELTIF 2.0 (Regulation (EU) 2023/606 amending the ELTIF Regulation) was published in the OJ. ELTIF 2.0 entered into force on 9 April 2023 and applies from 10 January 2024.

For details of the revised ELTIF Regulation, see our OnPoint "ELTIF 2.0: retailization of private funds – the gateway to heaven or a storm in a teacup?" available here.

ELTIF 2.0 provides that ESMA is to develop RTS to determine:

- criteria for establishing the circumstances in which the use of financial derivative instruments solely serves hedging purposes;
- the circumstances in which the life of a ELTIF is considered compatible with the life-cycles of each of the individual assets, as well as different features of the redemption policy of the ELTIF;
- the circumstances for the use of the matching mechanism, i.e. the possibility of full or partial matching (before the end of the life of the ELTIF) of transfer requests of units or shares of the ELTIF by exiting ELTIF investors with transfer requests by potential investors;
- the criteria to be used for certain elements of the itemised schedule for the orderly disposal of the ELTIF assets; and
- the costs disclosure.

[60] See here.
[61] The final report of Article 19 of the CSDR RTS is available here.
[62] The amending Delegated Regulation is available here.
[63] The CSDR Q&As are available here.
[64] The legislative proposal for amendments to the ELTIF Regulation is available here.

On 23 May 2023, ESMA published a consultation paper[65] setting out the draft text of the RTS. The RTS state that the provisions will enter into force on the day following its publication in the OJ (and not 20 days after publication), as it is important that the RTS enter into force as soon as possible after ELTIF 2.0 itself enters into force. Comments can be made on the proposals until 24 August 2023. ESMA will consider feedback received in Q3 or Q4 2023 and expects to publish a final report and submit the final draft RTS to the EU Commission for endorsement by 10 January 2024.

Although the UK on-shored the ELTIF Regulation, it is not proposing to make amendments to the UK ELTIF. In fact, as part of the Edinburgh Reforms (see 4.3 below), the UK government has announced plans to repeal the on-shored UK ELTIF.

3.6 EU European Market Infrastructure Regulation (EMIR)

EMIR 3.0: On 7 December 2022, the EU Commission published a number of proposals[66] to further develop the CMU, including a proposed regulation on clearing (so-called **EMIR 3.0**). Central to EMIR 3.0 is a proposal designed to make EU CCPs more attractive and to reduce what the EU Commission sees as "*excessive exposures*" of EU market participants to systemically important third-country CCPs, the so-called "active account" requirement. Under the proposals, financial counterparties (**FCs**) and non-financial counterparties (**NFCs**) subject to the clearing obligation will be required to hold active accounts, directly or indirectly through a clearing member, at one or more authorised EU CCPs and to clear at those EU CCPs at least a portion (as yet undetermined) of the derivative contracts that were identified by ESMA[67] as being of substantial systemic importance for the financial stability of the EU or one or more of its Member States. For more detail on the active account requirement and on the other key proposals of EMIR 3.0, please see the First Edition 2023 of the Horizon Scanner.

EMIR 3.0 is progressing through the European legislative process. Since the start of the year there have been a number of developments, although there is no consensus on the way forward:

- On 20 March 2023, the European Systemic Risk Board (**ESRB**) published a letter to each of the European Parliament and the Council about the EMIR 3.0 legislative proposal. In addition, on 28 April 2023, following requests from the European Parliament and Council, the European Central Bank (**ECB**) published an opinion (dated 26 April 2023) on EMIR 3.0, including specific drafting proposals for EMIR 3.0.
- On 14 June 2023, the ECON published its draft report[68], noting that the EU Commission's proposal is a "*good starting point for the discussions, but it is clear that there is room for improvement*". The ECON's proposed amendments focus on three main objectives: increasing the attractiveness and the competitiveness of the EU clearing ecosystem; increasing the demand for clearing services at EU CCPs; and establishing an adequate supervisory framework.
- On 20 June 2023, the Council published a progress report on the Swedish Council Presidency's work on EMIR 3.0, prior to the Presidency changing on 1 July 2023 (the Spanish Presidency will take over from the Swedish Presidency). In the progress report, the Swedish Presidency expresses its belief that significant progress has been made during the first half of 2023 towards reaching a Council position and that the outlines of a compromise have emerged in a number of areas. However, the report notes that due to the complexity of the subject matter and diverging views on core issues, further discussions are needed in all areas.

Negotiations between the three legislative bodies of the EU will continue throughout 2023 as they try and agree on the final text of EMIR 3.0. The Spanish Presidency of the Council has stated its intention to reach agreement within the Council on a general approach and then begin trialogue negotiations with the European Parliament before the end of the year. The RTS on the active account requirement will be submitted to the EU Commission within 12

[65] The consultation paper on the draft RTS for ELTIF 2.0 is available here.

[66] The text of the proposals, including EMIR 3.0 is available here.

[67] ESMA's report is available here.

[68] The ECON Report on EMIR 3.0 is available here.

months of EMIR 3.0 being published in the OJ. The expectation is that the active account RTS will be in place before the expiry of the UK CCP equivalence decision (i.e., before 30 June 2025).

EMIR REFIT – changes to the EMIR reporting obligation: As referenced in previous versions of the Horizon Scanner, significant changes to the EMIR reporting regime are afoot. The changes are extensive and will affect all counterparties that are required to report under the EMIR derivatives reporting regime, whether they delegate reporting to a third party or report directly themselves. Headline changes include increases and changes in reportable fields; end to end XML reporting and new validation rules, new requirements to notify NCAs of significant reporting issues; new arrangements under mandatory reporting; and detailed and specific procedures and standards for trade repositories (**TRs**) to verify and reconcile data in reports.

On 10 June 2022, the EU Commission adopted a series of six implementing and delegated regulations setting out ITS and RTS supplementing EMIR in relation to reporting, data quality and data registration of trade repositories under EMIR REFIT (**Technical Standards**) that were published in the OJ[69] on 7 October 2022, and that form the primary legislative basis for the updated regime. Publication of the Technical Standards set the timing for implementation of the new requirements and reports will need to be made in accordance with the new standards from **29 April 2024**. The changes apply not only to the reporting of derivatives concluded after the new reporting start date, but also to reports relating to derivatives outstanding on 29 April 2024. To help in-scope entities transition to the new regime, an additional transition period of 180 calendar days (i.e., until 29 October 2024) has been granted to upgrade outstanding contracts that have been submitted to TRs before 29 April 2024. Derivative contracts that mature before 29 October 2024 do not need to be updated. Any modification or termination of a pre-29 April 2024 derivative will prompt an earlier upgrade to the new standard.

On 20 December 2022, ESMA published its Final Report on EMIR reporting, including final Guidelines[70] on the new rules described above. Publication of the Guidelines was accompanied by the validation rules and the reporting instructions.[71] The Guidelines will be translated and published in all EU languages. They apply from 29 April 2024.

EMIR reporting continues to be a focus for European regulators. Both the CSSF and the Maltese Financial Services Authority (**MFSA**) have issued materials on the forthcoming EMIR reporting changes.[72] In addition, in early June 2023, the CSSF and Commissariat aux Assurance held a joint conference on EMIR reporting.[73]

ESMA consults on amendments to guidelines on position calculation under EMIR: On 28 March 2023, ESMA published a consultation paper on amendments to its guidelines on position calculation. The amendments to the guidelines are to ensure that TRs calculate positions in derivatives in a harmonised and consistent manner in accordance with Article 80(4) of EMIR, as amended by Technical Standards introduced under the EMIR REFIT Regulation. ESMA will consider the feedback to this consultation and expects to publish a final report on these amended Guidelines during Q3 2023 to allow for at least a six-month implementation period before the go-live of the EMIR REFIT reporting changes on 29 April 2024.

Questions and Answers: On 31 March 2023, ESMA published an updated version of its EMIR Q&As.

EMIR in the UK: See 4.9 below for updates in relation to UK EMIR, the UK "on-shored" version of EMIR.

[69] The RTS and ITS are available here. Note that on 24 November 2022, a corrigendum to Commission Implementing Regulation (EU) 2022/1860 laying down ITS under EMIR with regards to the standards, formats, frequency and methods and arrangements for reporting was published in the OJ. The corrigendum replaces the text "in accordance with paragraphs 2 to 14" in Article 4(1) on page 71 with "in accordance with paragraphs 2 to 13." A further corrigendum to the same ITS was published on 11 May 2023. The corrigendum inserts the date of application of the ITS (that is, 29 April 2024) into Article 10 (relating to the date by which derivative contracts are to be reported).

[70] ESMA's Final Report – Guidelines for reporting under EMIR.

[71] The validation rules and the reporting instructions are available here and here.

[72] The CSSF's Circular on the Technical Standards is available here and the MFSA's Circular is available here.

[73] The CSSF Communique with respect to the joint conference is available here.

Please refer to the Spring 2022 edition, the Summer 2022 edition, the Autumn 2022 edition and the First Edition 2023 of the Horizon Scanner for full details on other matters relating to EMIR, such as the effects of LIBOR cessation and benchmark reform on the clearing and trading obligations.

3.7 MiFID II

Commission's proposed amendments MiFID II and MiFIR: In November 2021, the EU Commission published the texts of its proposals to amend MiFIR and MiFID. Details of the EU Commission's proposed amendments to MiFID II and MiFIR regimes are available in the Summer 2022 edition of the Horizon Scanner.

Trilogue discussions began on 3 April 2023. On 29 June 2023, the European Parliament published a press release announcing it has reached provisional political agreement with the Council of the EU on the proposed amendments MiFIR and MiFID II. The Council has also published a press release.

The press releases include the following summaries:

- EU consolidated tape: negotiators agreed on an EU-wide consolidated tape (CT), an electronic system that will combine best bid and offer (EBBO) with corresponding sales volumes from different exchanges, without identification of trading venues, and will disseminate these in real time, providing a single reference price for shares and exchange traded funds across markets. The CT will continuously disseminate post-trade data with identification of the trading venue of the transaction;
- Payment for Order Flow (PFOF): negotiators agreed that the practice of receiving PFOF will be banned across Europe immediately, with the exception of certain countries where PFOF is more common. These countries will have to implement the ban before 30 June 2026; and
- Investor protection, commodities and orderly trading: negotiators decided that the EU Commission's review of position limits and position management controls would focus on facilitating energy transition, food security, markets' resistance to external shocks and achieving competitive and liquid markets. The ancillary activity exemption would also be reviewed, as well as a goal to harmonise commodity and emission allowance derivatives transactions in terms of data collection, formats and dissemination to the public. The co-legislators also reached an agreement on amendments proposed by Parliament on commodity derivatives. The text also mandates member states to require regulated markets to be able to temporarily halt or constrain trading in emergencies or if there is a significant price movement in a financial instrument and, in exceptional cases, to be able to cancel, vary or correct any transaction.

The provisional political agreement will have to be approved by the Parliament's ECON and the Council's Permanent Representatives Committee, followed by a plenary and Council vote.

ESMA Suitability Guidelines: Between 27 January and 27 April 2022, ESMA consulted on suitability requirements under MiFID. As noted in Section 1 – ESG, the MiFID II Delegated Regulation has been updated to integrate sustainability factors, risk and preferences into certain organisational requirements and operating conditions for investment firms (Commission Delegated Regulation (EU) 2021/1253). The purpose of the consultation related to the 2018 MiFID II Guidelines on MiFID II suitability requirements. On 23 September 2022, ESMA published its final report incorporating the revised guidelines in Annex IV[74] on certain aspects of the suitability requirements under the MiFID II Directive. Changes relate to the collection of information from clients on sustainability preferences, assessment of sustainability preference; and organisational requirements, to reflect the changes already made to the MiFID II Delegated Regulation.

On 3 April 2023, ESMA published Guidelines on certain aspects of the MiFID II suitability requirements. The official translations of these guidelines are available on the ESMA website. The guidelines apply from 3 October 2023. The publication of the translations triggered a two-month period during which NCAs must notify ESMA whether they comply or intend to comply with the guidelines. On 24 May 2023, the CSSF issued a circular[75] (dated 16 May

[74] The final report, incorporating the revised guidelines in Annex IV is available here.
[75] The CSSF circular is available here.

2023) confirming that, in its capacity as competent authority, it will apply the ESMA Suitability Guidelines from 3 October 2023 onwards. The CSSF will integrate the guidelines, issued with a view to promoting supervisory convergence in this field at European level, into its administrative practice and regulatory approach.

ESMA guidelines on MiFID II remuneration: On 3 April 2023, ESMA published the official translations of its Guidelines on certain aspects of the MIFID II remuneration requirements. The official translations of these guidelines are available on the ESMA website. ESMA published a report on the final version of these guidelines in March 2022. The guidelines apply from 3 October 2023.

ESMA Consultation on Product Governance Guidelines: Between 8 July and 7 October 2022, ESMA consulted[76] on reviewing the guidelines on MiFID II product governance requirements. ESMA also proposed updating the 2017 product governance guidelines following several recent regulatory and supervisory developments, including the outcome of the 2021 CSA on product governance.[77] The main proposals in the draft guidelines relate to:

- The specification of any sustainability-related objectives with which a product is compatible;
- The practice of identifying a target market per cluster of products instead of per individual product;
- The determination of a compatible distribution strategy where a distributor considers that a more complex product can be distributed under non-advised sales; and
- The periodic review of products, including the application of the proportionality principle.

The consultation paper also included good practices identified in the 2021 CSA to complement the existing guidelines, as well as an additional case study. On 27 March 2023, ESMA published its final report. ESMA has made amendments and clarifications following stakeholder feedback. The final guidelines build on the text of the current ESMA guidelines, taking into account recent regulatory and supervisory developments. The guidelines will be translated into the official languages of the EU and published on ESMA's website. They will apply two months after the date of publication.

Questions and Answers: ESMA published updated Q&As on MiFID and MiFIR transparency issues on 31 March 2023.

ESMA published an updated version of its Q&As on markets structures issues under MiFID II and MiFIR on 16 December 2022.

On 23 September 2022, ESMA published updated Q&As on MiFID II and MiFIR commodity derivatives topics.

ESMA published an updated version of its Q&As on MiFIR Data Reporting on 31 March 2023.

The UK has also introduced changes to UK MiFID similar to the 'quick fix' Directive, most of which were effective from 26 July 2021 (see the First Edition 2023 of the Horizon Scanner for details on UK MiFID).

3.8 EU Commission Review of AML Regime

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

The EU Commission had aimed to adopt legislative proposals in 2022 and bring the new regime into force in 2025. Certain provisions of the AMLA Regulation were expected to apply from 1 January 2023, to enable the AMLA to be established. Political agreement is expected in 2023, but the original timing has slipped. For further details, see the Summer 2022 edition and the Autumn 2022 edition of the Horizon Scanner.

[76] The consultation paper is available here.
[77] The report on the CSA is available here.

Following the Council's publication in June 2022 of a report[78] detailing its progress of the package of AML/CFT proposals, on 7 December 2022 the Council announced[79] it had adopted a position on the proposed Regulation on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (**AML Regulation**), the proposed Directive on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and repealing Directive (EU) 2015/849 (2021/0239(COD)) (**MLD6**).

In addition, the Council published a note[80] dated 5 December 2022 containing the text of the AML Regulation, as well as a note[81] (also dated 5 December 2022) containing the text of MLD6. These texts reflect the Council's mandate for negotiations with the European Parliament.

On 28 March 2023, the European Parliament's Economic and Monetary Affairs and Civil Liberties, Justice and Home Affairs committees adopted their position on three pieces of draft legislation on the AML/CFT policy. Points to note are:

- **Prevention of money laundering and terrorist financing**: According to the adopted texts, entities, such as banks, assets and cryptoassets managers, real and virtual estate agents and high-level professional football clubs, will be required to verify their customers' identity, what they own and who controls the company. They will also have to establish detailed types of risk of money laundering and terrorist financing in their sector of activity, and transmit the relevant information to a central register. To restrict transactions in cash and cryptoassets, MEPs want to cap payments that can be accepted by persons providing goods or services. They set limits up to €7000 for cash payments and €1000 for cryptoasset transfers, where the customer cannot be identified. Given the manifest risk of misuse by criminals, MEPs want to ban any citizenship by investments schemes ("golden passports") and impose strong AML controls on residence by investment schemes ("golden visas").
- **Financial Intelligence Units**: Each member state should establish a financial intelligence unit (**FIU**) to prevent, report and combat money laundering and terrorist financing. FIUs should share information with each other and with competent authorities as well as cooperate with AMLA, Europol, Eurojust and the European Public Prosecutor's office.
- **Information on beneficial ownership**: To detect money laundering schemes and freeze assets in time, national FIUs and other competent authorities should be able to access information on beneficial ownership, bank accounts, land or real estate registers. As certain commodities are attractive for criminals, MEPs also want member states to aggregate information on ownership of goods such as yachts, planes and cars worth over €200 000 or goods stored in free zones. MEPs agreed that beneficial ownership means having 15% plus one share, or voting rights, or other direct or indirect ownership interest, or 5% plus one share in the extractive industry or a company exposed to a higher risk of money laundering or terrorist financing.
- **Beneficial owners' registers**: Information on beneficial ownership held in national central registers should be available digitally, in an EU official language plus English, and include current and historical information for a defined period. The entity in charge of the central register will have the right to request from corporate and legal entities any information necessary to identify and verify their beneficial owners. This information will have to be up to date and available to FIUs, AMLA, competent authorities, self-regulatory bodies and obliged entities. Failure to provide accurate and adequate data to registers will be sanctioned. Entities in charge of central registers should be able to employ an adequate technology to carry out verifications.

The European Parliament published a press release on 19 April 2023, announcing that it had approved its negotiating mandates for the AML Regulation, the AMLA Regulation and MLD6. The draft negotiating mandates

[78] The report is available here.

[79] The press release is available here.

[80] The note is available here. A separate note included the annexes to the AML Regulation, available here.

[81] The note containing in the text of MLD6 is available here.

were announced at the opening of the European Parliament's 17 April 2023 plenary session. The text of the adopted report on the AMLA Regulation was published on 12 April 2023 and the text of the adopted report on the AML Regulation, as well as the text of the adopted report on MLD6, were published on 14 April 2023.

The first Trilogue meeting took place on 11 May 2023.

With regards to the progress of the recast revised WTR (defined below), see 3.14 EU Regulation on Markets in Cryptoassets (MiCA) below.

3.9 EU Benchmarks Regulation

See Section 2 – LIBOR and Global Benchmark Reform (above) for more detail on recent developments relating to LIBOR's cessation and global benchmark reform and previous editions of the Horizon Scanner.

Following the end of the Brexit transition period, UK-based administrators were removed from the ESMA register of administrators as they were no longer EU administrators. Since then, UK administrators have qualified as third-country administrators. The EU Benchmarks Regulation (**EU BMR**) includes a transitional period until 31 December 2023.[82] During this period, EU27 supervised entities can use benchmarks provided by third-country administrators, including UK administrators, provided the benchmark is already used as a reference for financial instruments, financial contracts or for measuring the performance of an investment fund.

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

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

An EU Commission consultation in May 2022 sought views on potential improvements to the EU BMR as regards the rules applicable to third-country benchmarks and the impact of the third-country regime taking effect from 1 January 2024.

Between 1 March and 29 March 2023, the EU Commission sought feedback on its call for evidence on the scope and third-country regime of the BMR.[83] Two aims of the call for evidence were to (i) ensure continued access to non-EU benchmarks for EU businesses and investors and (ii) promote EU benchmark labels as an open standard under EU supervision.

The EU Commission said that very few third-country administrators have so far obtained access to the EU market through recognition or endorsement of their benchmarks, which makes little economic sense. The second item related to the supervisory status of non-EU benchmarks that are labelled as EU climate transition benchmarks or EU Paris-aligned benchmarks, which were introduced in 2019 to promote sustainable investing. The EU Commission's view is that that the supervisory status of non-EU benchmarks bearing EU climate benchmark labels will also need to be amended in the light of possible changes to the rules on the use of non-EU benchmarks. However, it does not intend to change the substantive requirements for the EU Climate Benchmark labels.

Following an ESMA consultation that was open from 8 July to 9 September 2022 on amendments to Commission Delegated Regulation (EU) 2018/1645, supplementing the EU BMR with regard to RTS for the form and content of an application for recognition, ESMA published a final report on 28 November 2022. In the report ESMA adjusted the draft RTS to take into account the different types of benchmarks and the related requirements. Following publication on the final report in November 2022, the amended draft RTS were submitted to the EU Commission, which had three months to decide whether to endorse them. At the time of writing, the draft RTS on recognition

[82] See here for the related 9 March 2021 ESMA Public Statement.

[83] The call for evidence is available here.

have not yet been endorsed by the EU Commission. However, the changes proposed in the draft RTS on recognition are being reflected in ESMA's proposals to amend the RTS covering the application for authorisation and registration (discussed in the paragraph below).

On 28 November 2022, ESMA published a consultation paper on amendments to Commission Delegated Regulation (EU) 2018/1646 supplementing the BMR with regard to RTS on the information that EU benchmark administrators must provide in applications for authorisation and registration. The consultation closed to responses on 31 January 2023. On 30 May 2023, ESMA published a final report on amendments proposed in the November 2022 consultation. The RTS need to be amended to reflect the changes made to the RTS on the recognition regime introduced in ESMA's final report on the review of the RTS for the form and content of an application for recognition (described above).

Questions and Answers: ESMA last updated the Q&As on BMR on 23 March 2023.

3.10 EU SFTR

The Securities Financing and Transaction Regulation (**SFTR**) reporting requirements went live in July 2020 and commenced in October 2020 for financial counterparties, including UCITS, AIFs and in-scope third-country entities not caught by the first phase in July 2020. ESMA guidelines on the calculation of positions by TRs under the SFTR started to apply from 31 January 2022. The guidelines are intended to make sure that uniform methodology is used under both EMIR and SFTR, bearing in mind specific requirements for Securities Financing Transactions (**SFT**) reporting. Changes included in the EU EMIR reporting requirements (see 3.6 above) also seek consistency between EMIR and SFTR reporting.

There are no major EU SFTR developments to note since the Autumn 2022 edition of the Horizon Scanner.

SFTR REFIT: 2022 did not bring the review of SFTR as had been previously expected. This was confirmed in a June 2022 letter[84] from ESMA to the EU Commission, regarding the prioritisation of ESMA's 2022 deliverables. Current timing of the SFTR review is unknown.

Questions and Answers: On 7 June 2023, ESMA published an updated version of its Q&As on complying with reporting requirements under SFTR.

The UK and SFTR: See 4.10 below for updates with respect to the UK "on-shored" version of SFTR, "UK SFTR."

3.11 Retail Investment Strategy

On 24 May 2023, the EU Commission adopted its new retail investment strategy (**RIS**). Related materials, including the legislative proposals, FAQs, a factsheet and impact assessment are available on the EU Commission's retail investments package webpage. One of the EU Commission's objectives as part of the 2020 CMU action plan was to make the EU an even safer place for individuals to save and invest long-term, and the intention is that the RIS helps achieve that objective.

The package consists of two "mutually reinforcing" legislative proposals:

- A proposed Directive amending the UCITS Directive, the Solvency II Directive (2009/138/EC), AIFMD, MiFID II and the Insurance Distribution Directive *(*(EU) 2016/97) (**IDD**) as regards the EU retail investor protection rules (referred to by the EU Commission as the **Omnibus Directive**). Annexes 1 to 3 of the Omnibus Directive have been published separately.
- A proposed Regulation amending the Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) (1286/2014) (**PRIIPs Regulation**) as regards the modernisation of the key information document (**KID**).

The Omnibus Directive: the proposal for the Omnibus Directive includes the following:

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

- Disclosure information: a number of 'improvements' to the regulatory disclosures framework which aim to ensure transparency for retail investors and enable them to take informed decisions.
- Protecting retail investors from misleading marketing communications and practices which emphasise benefits but downplay the risks: a number of new provisions to address the risk of unbalanced or misleading marketing communications emphasising benefits only, and to clarify the responsibilities of investment firms and insurance distributors in relation to marketing communications, including when using digital channels and when relying on third parties.
- Tackling bias in the advice process: conflicts of interests, inducements and the introduction of a strengthened 'best interest' test for MiFID and IDD. Specifically in relation to MiFID, the existing exemptions to the bans on inducements would continue to be applicable to the ban on inducements for execution-only services (e.g. payments or benefits which enable or are necessary for the provision of investment services, payments in relation to research, etc.). Minor non-monetary benefits not exceeding EUR 100 or of a scale and nature such that they could not be judged to impair compliance with the duty to act in the best interest of the retail investor are also allowed if they are clearly disclosed.
- Amending product oversight and governance rules to ensure that undue costs are not charged and that products deliver Value for Money to retail investors.
- Ensuring that suitability and appropriateness tests are better adapted to retail investors' needs: an obligation for investment firms to explain the purpose of the assessments to clients and customers in a clear and simple way, and to obtain all relevant information from clients and customers which may be necessary and proportionate for the assessments. Retail investors need to be informed, via standardised warnings, about the consequences on the quality of the assessment if they do not provide accurate and complete information. The suitability and appropriateness assessments need to be conducted in good time before the provision of the relevant investment service or before the customer is bound by an insurance contract or offer. A suitability assessment report needs to be provided to clients/customers sufficiently in advance of the conclusion of the transaction to enable clients to seek and receive additional clarifications, where needed. The need for portfolio diversification will be also added as one of the elements that distributors need to assess when considering the suitability of a specific product or service on the basis of information obtained from the client or customer, including information on any existing portfolios.
- Ensuring high professional standards for investment advisors: the revised rules aim to strengthen and align the requirements on the knowledge and competence of investment advisors.
- Client categorisation, easing restrictions for investors to qualify as professional: to ensure more appropriate classification of clients and to reduce administrative burdens, the proposals amend Annex II of MiFID, which contains the identification criteria for clients who may be treated as professional on request. The amendments include a reduction of the wealth criterion from EUR 500 000 to EUR 250 000, and the insertion of a possible fourth criterion relating to relevant education or training. The amendments also permit legal entities to qualify as professional on request by fulfilling certain balance sheet, net turnover and own funds criteria.

PRIIPs KID Amending Regulation: As regards the proposed Regulation amending the PRIIPs KID, the EU Commission says it is amending PRIIPs in line with the September 2020 CMU action plan. The proposals include:

- new sections in the KID with dashboards:
  - to provide investors with key ESG information on the sustainability aspects of products subject to the SFDR (including the minimum proportion of the PRIIP's investment associated with environmentally sustainable economic activities under the Taxonomy Regulation); and
  - summarising information about the total costs of the PRIIP and the summary risk indicator;

- a simplification of the rules on providing a KID by mandating electronic disclosure (unless the client has requested a paper version);
- use of layering in the digital provision of a KID specifying the disclosure of costs information with respect to Multi-Option Insurance Products (MOPs) to promote choice between different products;
- the removal of the comprehension alert ('You are about to purchase a product that is not simple and may be difficult to understand') at the start of the KID; and
- confirming that some corporate bonds with make-whole clauses are out of scope of the PRIIPs Regulation.

The European Parliament and the Council will now scrutinise the legislative proposals.

3.12 EU PRIIPs Regulation

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

To recap, UCITS management companies and investment companies, and persons advising on or selling units of UCITS were originally exempt from the obligations under the PRIIPs Regulation until 31 December 2019. This exemption was subsequently extended to 31 December 2022. The UCITS exemption has now expired, and from 1 January 2023 UCITS management companies and investment companies must provide a PRIIPs key information document (**KID**) (as opposed to a UCITS key investor information document (**KIID)**) to retail investors in the EU.

The EU Commission is currently reviewing the regulation on the PRIIPS KID as part of its Retail Investment Strategy (see 3.11 above).

Q&A: On 18 May 2023, the ESAs published a set of consolidated Q&As (JC 2023 22) on the KID and related Delegated Acts.

3.13 EU Digital Operational Resilience for the Financial Sector (DORA)

Details on DORA and the directive to align certain existing EU financial services legislation with DORA, which proposes amendments to operational risk or risk management propositions in AIFMD, UCITS Directive and MiFID II Directive (**DORA Amending Directive**), are available in the Autumn 2022 edition of the Horizon Scanner.

On 27 December 2022, DORA[85] and the DORA Amending Directive[86] were published in the OJ. Both acts entered into force on 16 January 2023. DORA will apply from 17 January 2025 and Member States are required to apply measures implementing the DORA Amending Directive from the same date.

DORA requires the EU Commission to adopt two delegated acts specifying (i) the designation criteria for critical ICT third-party service providers (Article 31) and (ii) the amount of fees to be levied on such providers and how they are to be paid (Articles 33-43). On 26 May 2023, the ESAs published a discussion paper[87] on the delegated acts, with a deadline for comments of 23 June 2023. The discussion paper puts forward proposals on: (i) the elements to be considered when assessing the critical nature of ICT third-party service providers (**CTPPs**) - in particular, a number of relevant quantitative and qualitative indicators are proposed for each of the criticality criteria, along with the necessary information to build up and interpret such indicators; and (ii) the amount of the fees levied on CTPPs and the way in which they are to be paid. In particular, proposals are made on the types of expenditure

[85] DORA (Regulation (EU) 2022/2554 on digital operational resilience for the financial sector and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014, (EU) No 909/2014 and (EU) 2016/1011) is available here.

[86] DORA Amending Directive (Directive (EU) 2022/2556 Directive (EU) 2022/2556 amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU, 2014/65/EU, (EU) 2015/2366 and (EU) 2016/2341 as regards digital operational resilience for the financial sector) is available here.

[87] The discussion paper is available here.

to be covered by fees, the appropriate method, basis and available information for determining the turnover of the CTPPs as well as the method of fee calculation and other practical issues regarding the payment of fees.

3.14 EU Regulation on Markets in Cryptoassets (MiCA)

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

The Council adopted its negotiating mandate on MiCA on 24 November 2021. Trilogues between the co-legislators started on 31 March 2022 and ended in a provisional agreement reached on 30 June 2022.

On 9 June 2023, the following Regulations were published in the OJ:

- Regulation (EU) 2023/1114 on markets in cryptoassets and amending Regulations (EU) 1093/2010 and (EU) 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (**MiCA**).
- Regulation (EU) 2023/1113 on information accompanying transfers of funds and certain cryptoassets and amending Directive (EU) 2015/849 (**recast revised WTR**).

MiCA entered into force on 29 June 2023. It will apply from 30 December 2024, although some provisions apply from 29 June 2023 and some apply from 30 June 2024.

The recast revised WTR entered into force on 29 June 2023 and applies from 30 December 2024. On that date, Regulation (EU) 2015/847 (**revised WTR**) will be repealed.

For more information on the background to MiCA, see our OnPoint "Countdown to MiCA: The EU's cryptoassets regulation" available here and the Summer 2022 edition and the First Edition 2023 of the Horizon Scanner. See also our OnPoint, "Overview of cryptoasset class regulations in the EU and the US", available here.

3.15 EU Securitisation Regulation

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

EU Commission Report on the functioning of the Securitisation Regulation: On 10 October 2022, the EU Commission published a report[88] on the Securitisation Regulation (the **Report**). For full details of the Report, please see our OnPoint "European Commission report on securitisation regulation says EU investors may not invest in securitisations if the sell-side entities are not in compliance with EU reporting standards", available here.

Under the EU Securitisation Regulation, one of the requirements for STS securitisations is homogeneity of underlying exposures. In July 2022, the EBA launched a consultation on draft RTS specifying the criteria for the underlying exposures in simple, transparent and standardised (**STS**) securitisations to be considered homogeneous. The draft RTS will amend Delegated Regulation (EU) 2019/1851 (**Existing RTS**), specifying criteria for homogeneity for asset backed commercial paper (**ABCP**) and non-ABCP securitisations, and will apply to all STS securitisations, including ABCP, non-ABCP and on-balance sheet securitisations. On 14 February 2023, the EBA published its final report on the draft RTS which largely reflect those in the consultation, but with some clarifications. Notably the EBA has decided not to introduce a large corporates definition for the "type of obligor" but to retain the current distinction based on SME and non-SME corporate obligors. One other modification is to include a grandfathering provision that provides that STS on-balance-sheet securitisations which

[88] The EU Commission's Securitisation Report is available here.

were deemed homogeneous as part of the STS designation before the entry into force of the amending RTS will remain STS compliant. The RTS have been submitted to the EU Commission for endorsement.

EBA Guidelines on interpretation of STS criteria: The EBA published its final report on guidelines for the interpretation of the STS criteria on 12 December 2018. On 23 April 2023, the EBA published a consultation[89] on its draft guidelines proposing targeted amendments to the December 2018 guidelines. The consultation closes on 7 July 2023.

Questions and Answers: ESMA also updated its Q&As on the Securitisation Regulation on 17 February 2023 to include 11 new questions.

See the Spring 2022 edition and the First Edition 2023 of the Horizon Scanner for details of other developments.

4. UK REGULATORY INITIATIVES

4.1 Is Brexit Done? Not Quite…

In the run up to Brexit, the UK government and the FCA implemented a Temporary Permission Marketing Regime (**TMPR**) to allow investment funds with a passport to continue temporarily marketing in the UK. The FCA also established a Temporary Permission Regime (**TPR**) that allows EEA-based firms that were passporting into the UK at the end of the transition period (31 December 2020) to continue operating in the UK within the scope of their previous passport permission for a limited period after the end of the transition period. This is subject to having notified the FCA that they wanted to join the TPR before the end of the transition period. During this limited period, these firms must seek full authorisation by the PRA or the FCA in the UK, if required, to continue to access the UK market. The TMPR was originally due to end three years after the end of the transition period, however the Financial Services Act 2021 (**FS Act**)[90] extends this to five years (i.e., 31 December 2025) to allow enough time for the government to complete any equivalence assessments and for funds in the TMPR to apply for recognition, either through the overseas fund regime (**OFR**) (see 4.5 below), or section 272 of the Financial Services and Markets Act 2000 (**FSMA**).

The FCA webpage summarising the rules that apply to firms in the TPR and fund operators in the TMPR advises that:

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

The Trade and Cooperation Agreement (the **TCA**) agreed by the EU and UK in December 2020 included no agreement on financial services. The "Joint Declaration on Financial Services Regulatory Cooperation" that accompanied the TCA provided that the parties would aim to agree, by March 2021, a Memorandum of Understanding (**MoU**) establishing a framework for regulatory cooperation on financial services. The text of the MoU was reported to have been agreed to in March 2021 but was not published at the time. On 27 June 2023 HM Treasury published an updated webpage announcing that the MoU had been signed. HM Treasury has also published the final version of the MoU, having published a draft on 19 May 2023.

The MoU creates the administrative framework for voluntary regulatory cooperation in the area of financial services between the EU and the UK, outside of the TCA structures. This includes the establishment of a Joint EU-UK Financial Regulatory Forum, which will serve as a platform to facilitate structured dialogue on issues related to

[89] The EBA's consultation is available here.

[90] See the Summer 2022 edition and the Autumn 2022 edition of the Horizon Scanner for details of the FS Act.

financial services, similar to what the EU Commission has with other third country jurisdictions, such as the United States. The first meeting of the Forum is expected to take place in autumn 2023.

Notably, and something that was expressly emphasised by the EU,[91] the MoU does not deal with the access of UK-based firms to the Single Market – or EU firms' access to the UK market - nor does it prejudge the adoption of equivalence decisions, but the EU Commissioner's speech[92] announcing the signing of the MoU refers to the parties as having "*turned a page in our relationship*", adding that "*it's really positive that we have this structured cooperation in place*".

4.2 Financial Services Markets Bill 2022-23

On 20 July 2022, the Financial Services Markets Bill 2022-23 (the **FSM Bill**)[93] was introduced to Parliament. The FSM Bill is a lengthy 335 pages and is accompanied by explanatory notes[94] that run to 237 pages. The FSM Bill sets out the government's post-Brexit regulatory framework, as well as putting forward a number of proposals that make significant amendments to existing UK regulation.

The FSM Bill establishes the framework as set out in the Future Regulatory Framework (**FRF**) review of moving retained EU law – which includes a large number of detailed regulatory requirements in the primary legislation – off the UK's statute books and onto the rulebooks of the UK regulators (see First Edition 2023 of the Horizon Scanner for details of the FRF). This would follow the existing FSMA model.

It is important to note that the revocation of EU law is not immediate and would not take place until the FCA and/or PRA have drafted and consulted on replacement rules and those rules are ready to be put in place. This is a process that the government has indicated will take place over a period of years.

Other key provisions of the FSM Bill include amendments to UK MiFIR,[95] amendments to UK EMIR (see 4.9 below) and new regulatory powers, which include proposals to introduce (i) a Designated Activities Regime; (ii) a "regulatory gateway" for approving financial promotions (see 4.14 below); and (iii) proposals relating to Digital Assets. The FSM Bill introduces a general rule-making power for the BoE over CCPs and CSDs, enabling it to take primary responsibility for setting the regulatory requirements for these entities.

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

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

The FSM Bill received Royal Assent on 29 June 2023. The majority of the Financial Services and Markets Act 2023 provisions will come into force on dates appointed by HM Treasury in statutory instruments.

4.3 The Edinburgh Reforms

On 9 December 2022, in Edinburgh, the Chancellor of the Exchequer announced a set of reforms that are intended to drive growth and competitiveness in the financial services sector (the **Edinburgh Reforms**).[96] In summary, the Edinburgh Reforms aim to build "*a smarter financial services framework for the UK*". The UK government had already set this in motion by establishing the FRF review to determine how the financial services regulatory

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[91] See the 17 May 2023 press release announcing that the Commission has adopted a draft of the MoU here.

[92] The speech delivered by EU Commissioner McGuiness on 27 June is available here.

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

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

[95] For information on UK MiFIR, see the Summer 2022 edition of the Horizon Scanner.

[96] The Edinburgh Reforms are available here.

framework should adapt to the UK's new position outside the EU, and how to ensure that framework is fit for the future.

As part of the Edinburgh Reforms the government published a policy statement[97] setting out the implementation plan based on FSMA and the powers established in the FSM Bill (see 4.2 above). One of the main elements of this is how to deal with retained EU law (**REUL**) in primary and secondary UK legislation that, going forward, should primarily be in the regulators' rules rather than on the statute book. The government has identified 43 core files of financial services REUL, which are set out in Annex I to the policy statement. It intends to deliver the repeal of this law by splitting it into tranches, composed of a number of different files. HM Treasury sets out details of the files that comprise the first two tranches of the repeals process. It expects to make significant progress on Tranches 1 and 2 by the end of 2023. Notwithstanding that progress will be made, the expectation is that the work of reviewing and replacing REUL will be done over several years.

Of specific note, the government plans to repeal EU legislation on the ELTIF as it considers that the new UK Long-Term Asset Fund (**LTAF**) provides a better fund structure for the UK market, and that it will boost domestic fund management given the requirement that the LTAF must be managed by a full-scope UK AIFM. Meanwhile, in the EU, significant amendments are being made to the current ELTIF Regulation to improve its appeal as an EU fund vehicle (see 3.5 above). The ELTIF Regulation and UK's LTAF are not comparable regimes.

As part of the Edinburgh Reforms : (i) on 30 March 2023 a discussion paper and call for evidence was launched on the legislative framework of Senior Managers & Certification Regime, to garner views on its effectiveness, scope and proportionality, and on potential improvements and reforms; and (ii) on 30 March 2023 an updated Green Finance Strategy was published as a partial consolidation of the 2019 Green Finance Strategy and the 'Greening Finance' roadmap published in 2021. The updated strategy reflects the range of UK and international initiatives which have developed since COP26 and consulting between 30 March and 30 June 2023 on bringing Environmental, Social, and Governance ratings providers into the regulatory perimeter.

Also as part of the Edinburgh Reforms, HM Treasury has launched an independent review of investment research and its contribution to UK capital markets competitiveness (known as the Investment Research Review). A call for evidence for the Investment Research Review was subsequently published by HM Treasury on 3 April 2023. The deadline for responses was 24 April 2023.

With regards to securitisation – the government is also committed to bringing forward reforms identified in HM Treasury's 2021 review of the Securitisation Regulation (see 4.13 UK Securitisation Regulation below).

For full details, see our OnPoint "The Edinburgh Reforms" and the First Edition 2023 of the Horizon Scanner.

On 28 February 2023, the Financial Services Regulatory Initiatives Forum published the regulatory initiatives grid (the **Grid**)[98] for February 2023. The Grid was developed as part of the FRF review and its purpose is to set out details of regulatory initiatives relevant to the financial services sector that are planned for the next 24 months. The sixth edition of the Grid was due to be published in December 2022, but publication was delayed following the announcement of the Edinburgh Reforms as the government decided to take some additional time to consider any necessary changes to planned or new initiatives following the announcement.

The Forum intends to publish the next edition of the Grid towards the end of 2023. It also stated its intention to publish an interim statement once the FSM Bill received Royal Assent to provide details of any important and imminent changes to the Grid.

4.4 The Retained EU Law (Revocation and Reform) Bill 2022-23

On the 31 January 2022, the government set out its plans to bring forward the Retained EU Law (Revocation and Reform) Bill 2022-23 (the **Retained EU Law Bill**).

[97] The Policy Statement is available here.

[98] The February 2023 Regulatory Initiative Grid is available here and the FCA's related webpage is available here.

The original proposal (introduced to Parliament on 22 September 2022) was that Retained EU Law Bill would "sunset" the majority of REUL so that it would expire on 31 December 2023. All REUL contained in domestic secondary legislation and retained direct EU legislation would expire on this date, unless otherwise preserved. Any REUL that remained in force after the sunset date would be assimilated in the domestic statute book, by the removal of the special EU law features previously attached to it.

However, the government tabled a significant amendment on 10 May 2023 replacing the 31 December 2023 sunset clause with a list of retained EU laws that the government intends to revoke under the Retained EU Law Bill at the end of 2023.

The Retained EU Law Bill's provisions (including the list of law the government intend to revoke) excludes the bulk of retained EU law relating to financial services and there are no immediate proposals to revoke REUL relating to financial services. This will not take place until the FCA and/or PRA have drafted and consulted on and are ready to implement replacement rules. This process will take place over years, not months or weeks.

On 29 June 2023, the Retained EU Law (Revocation and Reform) Act 2023 received Royal Assent.

4.5 Proposals for an 'Overseas Funds Regime'

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

The FCA is now working on operationalising the OFR and will consult on various aspects of its Handbook rules to ensure OFR funds are appropriately captured. However, this process will not start until the equivalence assessments required as part of the OFR are finalised (see 4.1 above), with both likely to take place in Q4 of 2023.

4.6 FCA Future Regime for Asset Managers

As noted in the Spring 2022 edition, the UK undertook a number of strategic reviews to enhance the UK's regulatory framework, including the FRF review. The FRF review was established to determine how the existing financial services regulatory framework should adapt to the UK's position outside the EU. The FSM Bill (see 4.2 above) will legislate for these reforms.

HM Treasury launched a review of the UK funds regime in January 2021 covering tax and regulation. The call for input set out the scope and objectives of the review, and invited stakeholders to provide views on which reforms should be taken forward and how these should be prioritised. This was followed by a policy paper in 2022.[99] The government took forward two of the proposals, namely (i) a new tax regime for qualifying asset holding companies (**QAHCs**) in certain fund structures which took effect from 1 April 2022 and (ii) the introduction of the LTAF structure which came into effect in November 2021.

On 23 March 2023, the government published proposed amendments to the recently enacted QAHC regime. Seeking to help the QAHC regime better operate as intended, the amendments address issues with the existing rules, and when enacted should improve access to the regime for a wider range of fund structures. For more information, see our OnPoint "UK amends and clarifies the UK qualifying asset holding company (QAHC) regime", available here.

On 29 June 2023, the FCA published a policy statement on broadening retail access to the LTAF (PS23/7), setting out final rules to give retail investors and more defined contribution pension schemes access to LTAFs. The rules, which are set out in the Long-Term Asset Fund (Amendment) Instrument 2023,[100] comes into force on 3 July 2023 and subject LTAFs to additional protections under the FCA's high risk investment framework, by treating the LTAF as a restricted mass market investment (**RMMI**), in line with the FCA's approach for high-risk investments. The RMMI regime offers additional protections, including risk warnings and restricting the amount that retail investors

[99] The Policy Paper is available here.
[100] The Long-Term Asset Fund (Amendment) Instrument 2023 is available here.

can invest compared to the LTAF's previous distribution rules. The new rules therefore enable a broader range of retail investors and pension schemes to appropriately access the LTAF whilst ensuring they understand the risks involved.

Please refer to the April 2021 edition, the September 2021 edition, the Spring 2022 edition and the Autumn 2022 edition of the Horizon Scanner for full details of the Call for Input relating to the Review of the UK's funds regime and details of the LTAF.

Linked to the FRF review, in February 2023 the FCA launched a discussion paper (DP23/2)[101] to "*get a broad range of views about the current UK regime for regulating funds and asset managers*". DP23/2 also set out some ideas as to how the UK's regime might be modernised and improved.

The DP 23/2 notes that once the FSM Bill becomes law, the regulatory framework will change and HM Treasury and the financial services regulators will repeal REUL and replace it with firm-facing requirements in regulatory rulebooks. Feedback from DP23/2 will help shape the FCA's approach to rule-making under the new regulatory framework.

DP23/2 looks at:

(i) the structure of the asset management regulatory regime – in particular the broad issues around the rules for asset managers and funds. It considers areas where the rules could be simplified or restructured in a way that is proportionate to the risk of harm posed by activities, and taking account of the differing abilities of investors to manage those risks for themselves;

(ii) improving the way the regime works – in particular (a) the rules for authorised fund managers (**AFMs**), including responsibilities of host AFMs, enhancing liquidity management, investment due diligence; and (b) improving the fund rules, including the rules on eligible markets and the rules on prudent spread of risk; and

(iii) technology and innovation – particularly the role of technology in supporting better outcomes from authorised funds; areas in which the FCA might amend fund rules to support technological changes that could modernise fund propositions, including fund tokenisation and tokenised portfolio assets.

DP23/2 closed to comment on 22 May 2023 and a feedback statement is expected late 2023. The feedback statement may lead to consultation papers on some of the discussion topics.

In a more recent development, on 27 April 2023, the UK government published a consultation seeking views on the potential introduction, scope and design of a tax regime for a new type of unauthorised contractual scheme fund structure, referred to as a reserved investor fund (contractual scheme) (**RIF**). The RIF, as an unauthorised contractual scheme, would be a collective investment scheme (**CIS**) under FSMA. Under the UK's regulatory regime, the manager of an AIF – in this instance a RIF – must be either authorised by the FCA as a full-scope UK AIFM, a small authorised UK AIFM, or registered with the FCA as a small registered UK AIFM. The consultation closed on 9 June 2023.

4.7 A New Consumer Duty

To recap, the FCA's policy statement (**PS22/9**),[102] together with finalised guidance,[103] set out the final rules for a new consumer duty (the **Duty**). The rules comprise:

- A new Consumer Principle that requires firms to act to deliver good outcomes for retail customers;
- Cross-cutting rules providing greater clarity on FCA expectations (see below); and
- Rules relating to the four outcomes the FCA wants to see under the Duty, relating to (i) products and services; (ii) price and value; (iii) consumer understanding; and (iv) consumer support.

[101] DP23/2 is available here.

[102] PS22/9 is available here.

[103] FG22/5 is available here.

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

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

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

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

- For new and existing products or services that are open to sale or renewal, the rules come into force on 31 July 2023; and
- For closed products or services (that is, for products and services with existing customers but which are no longer open for sale or renewal), the rules come into force on 31 July 2024.

As discussed in the First Edition 2023 of the Horizon Scanner, on 2 December 2022, the FCA published its Quarterly Consultation (**CP22/26**), containing proposed changes and amendments to certain parts of the Duty, including:

- **Application of the Duty to firms in the TMPR**: The FCA clarifies the applicability of certain parts of the Duty to firms within the TMPR (the TMPR allows EEA fund managers to continue selling funds into the UK post-Brexit).
- **Application of the Duty to non-retail financial instruments**: Under the FCA's original rules, certain activities linked to financial instruments designed for wholesale investors are excluded from the scope of the Duty – particularly "non-retail financial instruments". The FCA's intention was that the exclusion would be used in relation to purely wholesale activities. However, the original wording might be interpreted as also excluding certain retail activity. For example, a firm creating a fund for another firm to sell to retail customers – such as an asset manager working with a pension provider, or an investment platform to design and manage funds for retail customers – may look to use the exclusions that are (amongst other things) financial instruments with a minimum denomination or otherwise a minimum investment of £50,000. To address this, the FCA proposed to amend this exclusion so that it is not available with respect to investment funds.

In Handbook Notice 108[104] (the FCA's response to CP22/26) published on 31 March 2023, the FCA (i) confirmed that firms within the TMPR will need to consider the Duty with regard to the approval and promotion of financial promotions to retail customers and (ii) to the relief of many, ***has not*** proceeded with its proposed changes to the £50,000 exemption that would have prevented investment funds from relying on a Duty exemption for products with a minimum investment amount of £50,000.

The Duty remains a key focus for the FCA, particularly as the implementation date for new and existing products nears. Firms must undertake fair value assessments as a way of demonstrating that the price a consumer pays for a product or service is reasonable compared to the overall benefits they can expect to receive. The FCA undertook a review of firms' fair value assessment frameworks under the Duty in January and February 2023 and published its findings on 10 May 2023.

The FCA's findings suggest that firms focus on the following areas:

- Collecting and monitoring evidence that demonstrates that products and services represent fair value.

[104] Handbook Notice 108 is available here.

- Ensuring that there is clear oversight and accountability of the necessary remedial actions if products and services are found not to provide fair value.
- Ensuring, where relevant, sufficient analysis of the distribution of outcomes across groups of consumers in the target market, beyond broad averages, to demonstrate how each group receives fair value.
- Summarising and presenting fair value assessments in a way that enables decision-makers to robustly discuss whether the product or service represents fair value, such as by being clear on any limitations in the analysis or evidence.

The FCA will continue to monitor firms' approach to ensuring customers receive fair value and this will include future reviews of fair value assessments of specific products and services.

On 28 June 2023, the FCA published a press release[105] reminding firms that there is only one month to go until the Duty comes into force for new and existing products and services. To support this preparation, in the press release the FCA highlights ten key questions firms should be asking to help identify and remedy gaps or areas for improvement on the implementation of the Duty.

For more information on the FCA's recent update on the road to implementation, see our OnPoint, "FCA Consumer Duty – Update on the Road to Implementation", available here.

4.8 UK Short Selling Regulation

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

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

As part of the Edinburgh Reforms (see 4.3 above), on 9 December 2022, HM Treasury published a call for evidence on the UK SSR.[106] The call for evidence sought views on how the government should reform the regulation on short selling and explains that the review of the UK SSR is intended to ensure that the UK's approach to regulating the short selling of shares admitted to trading reflects the specificities of UK markets, continuing to facilitate the benefits of short selling, whilst also protecting market participants and supporting market integrity. The call for evidence closed on 5 March 2023. See the First Edition 2023 of the Horizon Scanner for further details.

4.9 UK EMIR

The FCA has webpages dedicated to UK EMIR, EU EMIR news and key aspects of UK EMIR. See previous editions of the Horizon Scanner for details of post-Brexit amendments to UK EMIR and other updates prompted by global benchmark reform to the clearing obligations.

As noted in 4.2 and 4.3 above, under powers that will be granted under the FSM Bill, the government intends to repeal and, where appropriate, replace REUL relating to financial services, which will include UK EMIR. In the interim, the FSM Bill makes targeted amendments to UK EMIR.

UK EMIR REFIT including UK EMIR Reporting: Similar to reporting regime under EU EMIR (see 3.6 above), significant change is taking place under the UK EMIR reporting regime. The changes are expected to impact all entities that are in scope of UK EMIR reporting. Although the changes to the UK EMIR reporting regime are similar to the changes in the EU, they are not identical.

By way of reminder, in November 2021, the FCA and the BoE consulted on proposals to amend the framework for derivatives reporting under UK EMIR (**CP21/31**). The proposals aimed to align the UK derivatives reporting framework with international guidance issued by the Committee on Payments and Market Infrastructures and the

[105] The press release and key questions are available here.
[106] The UK SSR Call for Evidence is available here.

International Organization of Securities Commissions (CPMI-IOSCO). The consultation also proposed measures relating to mandatory delegated reporting requirements, counterparty notifications, registration and reconciliations processes, and the use of XML schemas and global identifiers.

On 24 February 2023, the FCA and BoE published a joint policy statement (**PS23/2**)[107] summarising feedback on CP21/31 and set out their final policy and rules that are designed to clarify trade reporting requirements under UK EMIR, including where there are discrepancies on how certain data fields are reported. The final rules are largely unchanged from the draft consultation versions, although some minor changes have been made in response to feedback received.

The new rules include:

- Amendments to the table of reportable fields in RTS under UK EMIR, primarily to align them with international guidance issued by CPMI-IOSCO.
- Amendments to the registration process for TRs.
- Requirements for TRs to establish procedures and policies to ensure the effective reconciliation of data between TRs, to verify the completeness and correctness of the data reported and the orderly transfer of data between TRs and to regulatory authorities.

The FCA is implementing the changes to the regime by introducing a new sourcebook in the FCA Handbook: the European Market Infrastructure Regulation Rules (**EMIRR**) and new binding technical standards.

The requirements set out in PS23/2 will come into effect on 30 September 2024, except for certain amendments to the UK versions of Commission Delegated Regulation (EU) No 150/2013 and Commission Implementing Regulation (EU) No 1248/2012 which relate to the format and details of applications for registration of TRs, and which come into force immediately.

As is the case with the EU rules, there will be a six-month period for counterparties to update their outstanding derivative reports in line with the new requirements, which will end **31 March 2025**.

Linked to the new UK EMIR reporting requirements, on 26 April 2023, the FCA announced it had published final versions of the UK EMIR Validation Rules and XML schemas on its UK EMIR reporting webpage. These will be applicable from 30 September 2024. The FCA states that the UK has predominantly aligned its EMIR REFIT policy with the proposals published by ESMA and that the FCA's technical specifications have been based on ESMA's technical specifications published 20 December 2022. The FCA has not yet published the supporting guidelines.

Please refer to the April 2021 edition, the Summer 2022 edition, the Autumn 2022 edition and First Edition 2023 of the Horizon Scanner for further details on UK EMIR.

4.10 UK SFTR

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

As noted in 4.2 and 4.3 above, under powers that will be granted under the FSM Bill, the government intends to repeal and, where appropriate, replace REUL relating to financial services, which will include UK SFTR.

There have been no significant developments with respect to the UK SFTR since the Autumn 2022 edition of the Horizon Scanner.

4.11 UK PRIIPS

The EU PRIIPs Regulation has applied across the EU since 1 January 2018. Like other directly applicable EU legislation, it became part of UK law at the end of the Brexit transition period (**UK PRIIPS**). Both the EU and UK

[107] PS 23/2 is available here.

PRIIPS Regulations set the requirements for a standardised disclosure document, known as KID, that must be provided to retail investors when they purchase particular packaged retail investment products (**PRIIPs**).

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

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

The FS Act has addressed some of the most urgent issues with the PRIIPs Regulation, but as part of the Edinburgh Reforms, (see 4.3 above) in a move that will likely be welcomed by many market participants, the government launched a consultation[108] on revoking the PRIIPs Regulation that forms part of REUL. The consultation, which ran for 12 weeks, closing on 3 March 2023, sought views on a new retail disclosure framework, as part of the FRF review. Under the new regime, the FCA proposes:

- Removing prescriptive requirements and increase flexibility for firms.
- Removing PRIIPs-type comparability. The government does however recognise that it will be necessary that certain information, such as costs, be standardised to a significant degree to ensure that it is understandable for investors and that some level of comparisons may be appropriate, for example between similar products that are broadly substitutable.
- Integrating both UCITS and PRIIPs disclosure into a coherent UK retail disclosure framework before 31 December 2026 when UCITS were intended to transition to the PRIIPs KID. The government states that both UCITS and PRIIPs rules can apply to very similar products in the retail investment market, and the government's view is that it would not be appropriate for different disclosure regimes to govern UCITS and PRIIPs in the long term. While the UCITS KIID has been less widely criticised than the PRIIPs KID, it remains a prescriptive format that can restrict firms' ability to tailor disclosure to their clients.

Going forward, it is the government's intention that retail disclosure requirements will be set out in FCA rules. The revocation of the PRIIPs Regulation will be commenced as a matter of priority following Royal Assent of the FSM Bill. The government will publish a consultation response and the FCA will consider changes to its rulebook to reflect this.

4.12 UK Benchmarks Regulation (UK BMR)

The FS Act (see previous editions of the Horizon Scanner and Section 2 LIBOR and Global Benchmark Reform above for details) makes amendments to the UK BMR. The FCA has published a document entitled "Benchmarks Regulation and amendments under the Financial Services Act 2021"[109] that summarises the amendments.

There have been no recent significant developments to the UK BMR.

4.13 UK Securitisation Regulation

As discussed in First Edition 2023 of the Horizon Scanner, the FSM Bill (see 4.2 above) will make amendments to the retained version of the EU Securitisation Regulation ((EU) 2017/2402) (**UK Securitisation Regulation**). The policy statement published as part of the Edinburgh Reforms (see 4.3 above) specifically stated that work is already underway on the first tranche of REUL in relation to delivering the outcomes arising from the 2021 Securitisation Review, and the government has also published an illustrative statutory instrument alongside this policy statement in order to give stakeholders a more detailed understanding of the approach the government is taking with regards

[108] The consultation is available here.

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

to the UK Securitisation Regulation. The statutory instrument[110] sets out the repeal and restatement of some elements of the UK Securitisation Regulation with a view to the replacement of most firm-facing requirements by rules made by the FCA and PRA, demonstrating how regulatory responsibility could look in regimes which involve more than one regulator under the enhanced FSMA model.

There have been no other significant developments to the UK Securitisation Regulation.

4.14 Financial Promotions Regime

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

To recap, the FCA consulted on proposals to amend the financial promotion approval regime by establishing a regulatory gateway for the approval of unauthorised persons' promotions. The FCA published a consultation paper (**CP22/2**)[111] setting out the FCA's proposed amendments to complement the Section 21 gateway. It also set out proposals for strengthening financial promotion rules for high-risk investments (**HRI**) and for firms approving financial promotions. Full details of the consultations are available in the Summer 2022 edition of the Horizon Scanner.

On 1 August 2022, the FCA published a policy statement (**PS22/10**)[112] on strengthening its financial promotion rules for high-risk investments and firms approving financial promotions and summarising the responses to CP 22/12. PS22/10 also contains the final rules, and non-Handbook Guidance, for firms when communicating or approving financial promotions. The rules relating to risk warnings for financial promotions of HRIs took effect from 1 December 2022. All other rules took effect from 1 February 2023.

In CP 22/2, the FCA set out its proposed rules for cryptoasset promotions. In PS 22/10, the FCA confirmed that final rules on the promotion of qualifying cryptoassets will be made once the relevant legislation has been made. See 4.16 below for details of the FCA's financial promotion rules for cryptoassets.

As a continuation of the July 2020 consultation on the "Regulatory Framework for the Approval of Financial Promotion" and the government's subsequent confirmation of a plan to introduce a new regulatory gateway for all authorised persons – under FSMA – wishing to approve financial promotions on behalf of unauthorised persons, in December 2022, the FCA published a further consultation (**CP22/27**).[113] In CP 22/27, the FCA consulted on the following proposals for the new gateway: (i) how to assess applicants at the gateway; (ii) the basis for granting or refusal of applications; (iii) a bi-annual reporting requirement for firms that are given permission to approve financial promotions; (iv) a requirement that firms that are granted permission to approve financial promotions must notify the FCA when they approve, or amend or withdraw approval of, a financial promotion, within seven days of doing so; (v) not extending the compulsory jurisdiction of the Financial Ombudsman Service to the approval of financial promotions; and (vi) further consequential changes made to the FCA non-Handbook guidance for firms that approve financial promotions for investments, and additional text on the Consumer Duty.

CP 22/27 closed on 7 February 2023 and the FCA is expected to publish a policy statements and final rules in H1 2023.

The government has signalled its plan to create a transition period for existing authorised persons, enabling them to continue approving financial promotions until their applications have been determined.

4.15 Regulation of Cryptoassets

In 2018, the government launched a cross-authority Cryptoassets Taskforce with the aim of exploring the impact of a rapidly developing cryptoasset market. At the time, the Cryptoassets Taskforce judged that the cryptoasset

[110] The UK Securitisation Regulation Draft Statutory Instrument is available here.

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

[112] PS 22/10 is available here.

[113] CP 22/27 is available here.

market was at an immature stage of development, and that there was limited evidence of the current generation of cryptoassets delivering benefits.

Five years on, the Cryptoassets Taskforce, together with the Payment Systems Regulator, continues to develop a regime for cryptoassets (including stablecoins). Recent events in cryptoasset markets – including the collapse of FTX – have highlighted the importance of establishing regulation that supports safe innovation and protects consumers and stability. The FCA and BoE have warned that cryptoassets are high risk, and that investors should be prepared to lose all of their money. See the Summer 2022 edition and the Autumn 2022 edition of the Horizon Scanner for full details.

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

On 13 July 2022, the UK Parliament's Treasury Committee launched a new inquiry and call for evidence into the cryptoasset industry. In the inquiry, which closed on 12 September 2022, the Committee explored the role of cryptoassets in the UK, as well as the opportunities and risks they bring to consumers and businesses. See the Autumn 2022 edition of the Horizon Scanner for full details of the inquiry and call for evidence.

In an HM Treasury committee meeting[114] that took place on 10 January 2023, the government stated that in the coming weeks it will be "*coming forward with a consultation document about the regulation of the cryptoasset sector in general, but also, in conjunction with the Bank of England, about what we should do about a sovereign digital currency*.

True to its word, on 1 February 2023, the UK government published its consultation on the future financial services regulatory regime for cryptoassets (the **Cryptoasset Consultation**). Per the introduction, the Cryptoasset Consultation "*sets out proposals for this future regime and marks the next phase of the government's approach to regulating cryptoassets. It builds on previous HM Treasury proposals, which focussed on stablecoins and the financial promotion of cryptoassets."* The government also noted that its proposed measures "*have been informed by recent market events – including the failure of FTX – which reinforce the case for effective regulation and sector engagement*."

The Cryptoasset Consultation proposes to bring a wide range of cryptoassets into the scope of UK regulation, together with activities relating to these cryptoassets. This will be done by amending the UK's existing FSMA rather than creating a new standalone regulatory regime. The new regime would oblige firms who wish to carry out FCA-regulated activities in relation to cryptoassets to apply for authorisation from the FCA. The regime will have extra-territorial effect and impose a crypto-specific market abuse regime based on the FCA's existing market abuse or "MAR". The proposals set out in the Cryptoasset Consultation will impact on the FCA's cryptoasset registration regime under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, as amended (**MLRs 2017**). (See 4.17 below for details of MLRs 2017). The Cryptoasset Consultation closed to comment on 30 April 2023. The government is now considering the responses received in order to formulate its own. Further technical consultations are likely to be issued on specific firm rules.

See our OnPoint **"**Treating Crypto Fairly: The New UK Government Consults on a Comprehensive Regulatory Regime for Cryptoassets" for further details.

Reform to the UK Investment Manager Exemption – Certain Cryptoassets Added to the Investment Transactions List: In the summer of 2022, the government consulted on extending the scope of the UK Investment Manager Exemption (the **UK IME**) to include direct transactions in cryptoassets. Our previous OnPoint on the consultation, including background on the UK IME, is available here.

[114] Oral evidence from the meeting is available here.

HMRC has now introduced regulations[115] to include certain cryptoassets as "investment transactions" within the scope of the UK IME with effect from the 2022-2023 tax year (for non-corporate entities) and accounting periods current as at 19 December 2022 onwards (for corporate entities). Accordingly, provided the other conditions of the UK IME are satisfied, UK-based investment managers can now trade in certain cryptoassets directly (rather than limiting their investment strategy to futures and options contracts in cryptoassets, or trading in cryptoassets outside the UK, as was previously the case) without the risk of the non-UK fund vehicle becoming subject to UK tax in respect of such transactions. For full details, see our OnPoint available here.

4.16 Financial Promotion of Cryptoassets

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

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

On 18 January 2022, the government published its response[116] to the July 2020 consultation. It noted respondents agreed that there are consumer risks in the cryptoassets market, and there was a case for intervention. The government response also clarified how HM Treasury intends to define "qualifying cryptoasset."[117]

On 1 February 2023, HM Treasury published a policy statement[118] on regulating certain types of cryptoasset financial promotions (subsequently updated on 27 March 2023).

HM Treasury is proposing a bespoke exemption from the financial promotion restriction in section 21 of FSMA for certain financial promotions relating to qualifying cryptoassets.

On 7 June 2023, the Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2023 (SI 2023/612) (**FPAO**) was published together with an explanatory memorandum. This exemption will enable cryptoasset businesses registered with the FCA under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (*SI 2017/692*), who are not otherwise authorised persons, to communicate their own financial promotions in relation to qualifying cryptoassets. Registered cryptoasset businesses relying on this exemption will not be able to approve financial promotions or to communicate their own financial promotions in relation to other controlled investments. This exemption will ensure that a cryptoasset exchange provider or custodian wallet provider registered under Regulation 54(1A) of the AML/CTF regulations will be able to communicate their own promotions in relation to qualifying cryptoassets.

Registered cryptoasset businesses seeking to use this exemption will not require any further FCA registration or authorisation.

The FPAO came into force on 8 June 2023 solely for the purpose of enabling the FCA to make rules and give guidance, it will apply on 8 October 2023 for all other purposes.

HM Treasury intends the exemption to be temporary. It will review its approach to the exemption as part of its wider review of the future regulatory approach to cryptoassets.

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[115] The Investment Manager (Investment Transactions) (Cryptoassets) Regulations 2022.

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

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

[118] The Policy Statement is available here.

The FCA also reminded firms that promotions that are not made using one of these routes will be in breach of section 21 of FSMA, which is a criminal offence punishable by up to two years imprisonment.

As noted in 4.14 above, in PS 22/10, the FCA confirmed that final rules on the promotion of qualifying cryptoassets would be once the relevant legislation has been made. Following publication of the legislation, on 8 June 2023, the FCA published PS 23/6.[119]

PS 23/6 summarises the feedback received to CP22/2 on cryptoassets and sets out the FCA's final policy position and near final Handbook rules. The FCA intends to proceed with categorising cryptoassets as 'Restricted Mass Market Investments' and applying the associated restrictions on how they can be marketed to UK consumers. The FCA is also making targeted changes to its consultation proposals to align with the rules set out in PS22/10 for other high-risk investments.

The FCA has also published a Guidance Consultation (GC23/1) on non-Handbook guidance, so firms clearly understand the FCA's expectations around the requirement that financial promotions are fair, clear and not misleading.

The financial promotions regime will apply to all firms marketing cryptoassets to UK consumers regardless of whether the firm is based overseas or what technology is used to make the promotion.

The FCA expects that the rules will have effect from 8 October 2023.

The FCA also specifically states that it will take robust action against firms breaching these requirements – reminding firms that illegally communicating financial promotions to UK consumers will be committing a criminal offence punishable by an unlimited fine and/or two years in jail.

For further details, see our OnPoint "FCA issues final rules for marketing cryptoassets in the UK", available here.

Further details are set out in the Spring 2022 edition and First Edition 2023 of the Horizon Scanner.

4.17 AML5 and Cryptoassets

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

Since 10 January 2020, the FCA has been the anti-money laundering and counter-terrorist financing (**AML/CTF**) supervisor of UK cryptoasset businesses under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, as amended (**MLRs 2017**). The FCA has a detailed webpage on the AML/CTF regime for cryptoassets.[120]

Cryptoasset transfer regime: Since 2017, the UK's AML/CTF regime has been reviewed by the Financial Action Task Force (**FATF**). The UK's AML/CTF regime goes beyond the requirements of the EU's Fifth Anti-Money Laundering Directive (**5MLD**) to comply with all but one of the FATF standards (recommendation 16, known as the travel rule). The travel rule requires cryptoasset businesses within scope of the MLRs 2017 to obtain, hold and transmit the identifying information of both parties in any cryptoasset transaction. The cryptoasset transfer regime has now been incorporated in the MLRs 2017, in a new Part 7A, which will come into force by virtue of regulation 5 of the Amendment Regulations 2022 on 1 September 2023.

The FCA has expanded its change in control regime to include FCA-registered cryptoasset businesses. From 11 August 2022, any person who decides to acquire 25 percent or more of an FCA-registered cryptoasset firm must receive prior FCA approval before completing the transaction. Failure to obtain such approval is a criminal offence. The obligation arises by virtue of new provisions in the MLRs 2017, which apply Part 12 of FSMA to

[119] PS 23/6 is available here.

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

cryptoasset businesses, with some modifications.[121] The changes give the FCA the opportunity to undertake a 'fit and proper' assessment of the proposed controller, as well as the power to object to the transaction and to make its reasons for objecting public.

On 17 February 2023, the FCA updated its webpage on change in control notification forms to include links to the relevant forms for use by persons intending to acquire control over an FCA-registered cryptoasset firm.

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

4.18 Review of the UK's AML/CFT Regulatory and Supervisory Regime

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

On 24 June 2022, HM Treasury published two post-implementation reviews and a forward-looking review of the UK's AML/CFT regime.[122] The post-implementation reviews cover the MLRs 2017 and also the Office for Professional Body AML Supervision Regulations (**OPBAS**), fulfilling HM Treasury's statutory obligations. In the works of HM Treasury, the forward-looking review is focused on *"improving the effectiveness of the [MLRs 2017], ensuring the application of effective risk-based controls across the regulated sector and developing a world-class AML supervisory regime*". See the Autumn 2022 edition of the Horizon Scanner for details of the review.

The government published its second Economic Crime Plan[123] (**ECP2**), covering the period 2023 to 2026, in March 2023. In ECP2 the government says that further reform of the AML/CFT supervisory regime is needed. The 2022 review laid out a shortlist of four options for reform,[124] and the government will consult further before selecting and implementing the chosen model. Any changes to the regime could take place over a period of years, particularly for major structural reform. In the interim, the government will continue to work with supervisors on shorter-term improvements to effectiveness. There will be a greater focus on effective supervision, including through the creation of the new performance framework recommended by the 2022 review, and the updated OPBAS sourcebook which focuses on driving improvements in effectiveness across the Professional Body Supervisors (**PBS**).

The annex to the most recent edition of the Grid (see 4.3 above) includes the Review of the UK's AML/CFT regulatory and supervisory regime in the list of initiatives that have been completed or stopped.

5. U.S. REGULATORY INITIATIVES

5.1 SEC Proposes Overhaul of Adviser Custody Rule

On 15 February 2023, the SEC proposed a major overhaul of the investment adviser custody rule. The proposal would amend and redesignate Rule 206(4)-2 under the Investment Advisers Act of 1940 (**Custody Rule**), as new Rule 223-1 under Section 223 of the Advisers Act (**Proposed Rule**). (See the Rule Proposal, SEC Release No. IA-6240 (15 February, 2023) (**Release**)).

The Proposed Rule seeks to restructure dramatically the way that qualified custodians provide custody services, as well as the nature and scope of advisers' responsibilities with respect to custody (reflected in the rebranding of the rule as "Safeguarding"). It would attempt to regulate custodians indirectly through a set of required undertakings to advisers and would require burdensome and intrusive new verification audits for private transactions. In these and many other ways, if adopted the Proposed Rule would have a significant impact on advisers, advisory clients, investors and the market for custody services. If adopted, among other matters, the Proposed Rule would:

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

[122] The Policy Paper is available here.

[123] The ECP2 is available here.

[124] The four options being OPBAS+, professional body supervisors (PBS) consolidation, single professional services supervisor (SPSS) and single AML supervisor (SAS).

- **Expand the Scope of Assets Covered Under the Rule**: expand the scope of assets covered by the rule to include all client "funds, securities, or other positions held in a client's account" for which an adviser has custody. Notably, the rule would apply to cryptoassets and physical assets of which an adviser has custody.
- **Expand the Scope of Activity Constituting Custody**: expand the definition of custody to include any discretionary authority to trade for a client's account.
- **Create New Requirements for Arrangements with Custodians**: require advisers with custody of client assets to enter into written agreements with, and obtain "reasonable assurances" from, each qualified custodian on certain matters.
- **Impose New Conditions on the Use of Foreign Financial Institutions**: impose new requirements on foreign financial institutions (**FFIs**) to meet the definition of "qualified custodian," including a requirement that FFIs be subject to anti-money laundering requirements similar to those imposed on U.S. institutions.
- **Impose New Requirements on Privately Offered Securities and Physical Assets**: impose new requirements on privately offered securities and physical assets that cannot be held at a qualified custodian, including new verification requirements.
- **Segregation Requirements**: subject client assets to new segregation requirements, including a requirement that client assets be segregated from the assets of the adviser and its related persons.
- **Audit Provision**: expand the audit provision exception to cover any entity that is subject to an annual audit, codify or expand timelines for distribution of audited financials for funds of funds (and funds of funds of funds), codify existing staff positions on the use of non-U.S. auditing standards for preparation of non-U.S. entity financials, and require a written agreement with the independent public accountant that would require the accountant to notify the SEC under certain circumstances.
- **Recordkeeping Amendments**: amend Rule 204-2 under the Advisers Act (Recordkeeping Rule) to impose new recordkeeping requirements related to the Proposed Rule.
- **Form ADV Amendments**: amend Form ADV to align reporting obligations with the Proposed Rule and increase the custody-related data available to the SEC.

The comment period for the Proposed Rule ended on 8 May 2023. For more information, see our OnPoint, available here.

5.2 SEC Adopts Significant Amendments to Form PF to Enhance Private Fund Reporting

On 3 May 2023, the SEC approved amendments (**Amendments**) to Form Private Fund (**Form PF**), a confidential reporting form for certain SEC-registered investment advisers to private funds. The Amendments relate to changes initially proposed in January 2022, and they do not cover the amendments to Form PF jointly proposed by the SEC and the CFTC in August 2022, which remain under consideration.

The Amendments will require large hedge fund advisers (with at least $1.5 billion in hedge fund AUM) and all private equity fund advisers (with at least $150 million in private equity fund AUM) to file current reports upon the occurrence of certain events that could indicate significant stress at a fund or investor harm (**Event Reporting Requirements**). Reporting events for large hedge fund advisers include certain extraordinary investment losses, significant margin and default events, terminations or material restrictions of prime broker relationships, operations events, and events associated with withdrawals and redemptions. Large hedge fund advisers must file these reports no later than 72 hours from the occurrence of the relevant event. Reporting events for private equity fund advisers include the removal of a general partner, certain fund termination events, and the occurrence of an adviser-led secondary transaction. Private equity fund advisers must file these reports on a quarterly basis within 60 days of the fiscal quarter end.

The amendments will also require large private equity fund advisers (private equity fund advisers with at least $2 billion in private equity AUM) to report information on general partner and limited partner clawbacks on an annual basis, as well as additional information on their strategies and borrowings as a part of their annual filing.

The Amendments will become effective on 11 June 2024, except for the Event Reporting Requirements, which will become effective on 11 December 2023.

For more information, see the Adopting Release, SEC Rel. No. IA-6297 (3 May, 2023).

5.3 SEC Staff Issues Risk Alert Relating to Marketing Rule Compliance

On 8 June 2023, the SEC's Division of Examinations issued a Risk Alert to inform registered investment advisers about additional areas of focus during staff examinations relating to the amended Rule 206(4)-1 (the **New Marketing Rule**). On 19 September 2022, the Division had published a previous Risk Alert describing the initial areas of review during exams for compliance with the New Marketing Rule. The latest Risk Alert confirms that the exam staff will continue to review the areas previously highlighted, as well as the following additional areas of emphasis in exams:

- **Testimonials and Endorsements**: whether advisers are in compliance with the New Marketing Rule requirements regarding the use of testimonials and endorsements in an advertisement.
- **Third-Party Ratings**: whether advisers are in compliance with the New Marketing Rule requirements regarding the use of third-party ratings in advertising.
- **Form ADV**: whether advisers accurately completed the questions in their annual Form ADV amendments requiring additional information regarding their marketing practices.

For more information, see the full Risk Alert here. Please see the Summer 2022 edition of the Horizon Scanner for full details of the New Marketing Rule.

5.4 SEC Staff Issues Risk Alert on Safeguarding Client Information at Branch Offices

On 28 April 2023, the SEC's Division of Examinations issued a Risk Alert highlighting the importance of establishing written policies and procedures for safeguarding customer records and information at branch offices. The Safeguards Rule of Regulation S-P (**Safeguards Rule**) requires registered investment advisers and broker-dealer firms to adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information. In assessing compliance with the Safeguards Rule, SEC exam staff have observed that although many firms implemented adequate policies and procedures for their main office, they often did not do so for branch offices. The staff identified several common issues related to branch office governance, including vendor management, email configuration, data classification, access management, and technology risk. Firms should consider their entire organisation, including branch offices, when implementing policies and procedures for safeguarding customer information under the Safeguards Rule.

For more information, see the full Risk Alert here.

5.5 SEC Adopts Final Rules to Require the Reporting of Executive Compensation Votes by Institutional Investment Managers

On 2 November 2022, the SEC adopted a new rule and form amendments (**Final Rules**) under the Securities Exchange Act of 1934 (**Exchange Act**) that require institutional investment managers subject to reporting requirements under Section 13(f) of the Exchange Act annually to report their proxy voting on Form N-PX with respect to certain shareholder advisory votes on executive compensation matters.

The Final Rules will be effective on 1 July 2024, with managers being required to file their first reports covering the period from 1 July 2023 to 30 June 2024 on amended Form N-PX by 31 August 2024, meaning that managers will need to begin maintaining the necessary records relating to their proxy votes on 1 July 2023.

For more information, see the First Edition 2023 of the Horizon Scanner, or see our OnPoint, available here.

5.6 SEC Proposes Rule Regarding Obligations for Advisers that Outsource Key Functions

On 26 October 2022, the SEC proposed new requirements (the **Proposed Rule**) under the Investment Advisers Act of 1940 regarding the oversight of both affiliated and third-party service providers by investment advisers registered or required to be registered with the SEC. See the SEC Proposed Rule, SEC Rel. No. IA-6176 (26 October 2022) (**Release**).

The Proposed Rule, if adopted, would prescribe minimum initial and ongoing due diligence and monitoring obligations for advisers for the outsourcing of "covered functions." Under the Proposed Rule, a covered function is any function: (1) that is necessary for the adviser to provide its investment advisory services in compliance with the Federal securities laws; and (2) that, if not performed or performed negligently, would be reasonably likely to cause a material negative impact on the adviser's clients or on the adviser's ability to provide investment advisory services. Whether a certain service is a covered function would be a fact-specific determination.

The public comment period has closed, and the industry expects a final rule to be adopted in the coming months. For more information, see the First Edition 2023 of the Horizon Scanner, or see our OnPoint, available here.

5.7 FinCEN Adopts Final Rule for Beneficial Ownership Reporting Requirements

On 29 September 2022, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (**FinCEN**) issued a final rule (**Final Rule**) defining and implementing the Corporate Transparency Act's (**CTA**) beneficial ownership information (**BOI**) reporting requirements. The rule describes who must file a BOI report, what information must be reported, and when a report is due. While the rule exempts most asset managers, certain private funds and exempt reporting advisers are not exempted and will have to report beneficial ownership information to FinCEN beginning on 1 January 2024.

The Final Rule becomes effective on 1 January 2024. Entities formed after the effective date must report within 30 days of formation. Entities formed prior to the effective date have until 1 January 2025 to report. For more information, see the First Edition 2023 of the Horizon Scanner, or see our OnPoint, available here.

5.8 SEC Proposes Substantial Changes to Private Fund Regulatory Regime

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

The public comment period for the proposals closed on 13 June 2022, and the industry expects the SEC to issue final rules imminently. Once the final rules are issued, the SEC is expected to provide a one-year transition period for advisers to come into compliance with the new and amended rules.

For more information, see our OnPoint, available here.

5.9 New Short Sale Reporting Scheme

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

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

5.10 Proposal to Modernise Beneficial Ownership Reporting (Schedules 13D and 13G)

On 10 February 2022, the SEC proposed rule amendments (the **Proposed Amendments**) to accelerate the filing deadlines for Schedule 13D and 13G filings, which are public reports to the SEC required for an investor who acquires beneficial ownership of more than five percent of a covered class of equity securities. (See the Proposed

Amendments, SEC Rel. No 33-11030 (10 February 2022)). On 28 April 2023, the SEC announced that it would re-open the public comment period for the Proposed Amendments, and comments should be sent on or before 27 June 2023.

Full details of the Proposed Amendments are available in the Summer 2022 edition of the Horizon Scanner.

5.11 Rules to Address Matters Related to Environmental, Social and Governance (ESG) Factors

At a meeting held on 25 May 2022, the SEC proposed requirements for investment companies and investment advisers related to environmental, social and governance (**ESG**) factors, including rules relating to fund names as well as ESG claims and related disclosures. Please see the Autumn 2022 edition of the Horizon Scanner for a summary of the proposed rules.

The public comment period for the proposal closed on 16 August 2022. There have been no recent significant developments. For further information, see our OnPoints, available here and here.

6. HONG KONG REGULATORY INITIATIVES

6.1 Virtual Asset Service Provider Licensing Regime

The Hong Kong Securities and Futures Commission (**SFC**) published its consultation conclusions on the regulation of virtual asset trading platforms[125] (**Conclusions**) on 23 May 2023. In the Conclusions, the SFC confirmed that virtual asset trading platforms licensed by the SFC (**VA Platforms**) can provide trading services to retail investors and finalised the Guidelines for Virtual Asset Trading Platform Operators (**VATP Guidelines**), which set out, among other things, standards and requirements expected of VA Platforms on investor protection requirements, safe custody of assets, segregation of client assets, avoidance of conflicts of interest and cybersecurity. The VATP Guidelines came into effect on 1 June 2023.

The virtual asset service provider licensing regime under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Chapter 615 of the Laws of Hong Kong) (**AMLO**) and the other guidelines and FAQs (set out below) also came into effect on 1 June 2023:

- Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers);
- Prevention of Money Laundering and Terrorist Financing Guideline issued by the Securities and Futures Commission for Associated Entities of Licensed Corporations and SFC-licensed Virtual Asset Service Providers;
- FAQs on licensing matters and conduct-related matters; and
- VATP Licensing Handbook.

The amended AMLO designates the business of operating a "virtual asset service" as a "regulated function" and requires any person engaging in that activity to obtain a VA Platform licence from the Securities and Futures Commission of Hong Kong (**SFC**). The VA Platform regime is primarily intended to capture the operation of a virtual asset (**VA**) exchange; other virtual asset activities are presently not covered by the licensing regime given their negligible presence in Hong Kong, but the scope could be expanded by the Hong Kong Government in the future if it considers necessary to do so. Notably, the current definition of VA Platform will not cover pure decentralized virtual exchanges. Licensed VA Platform will also be required to comply with the existing requirements under the AMLO on customer due diligence, similar to those applicable to more traditional financial institutions.

Under the amended AMLO, “VA” generally captures a cryptographically secured digital representation value that (a) is expressed as a unit of account or a store of economic value; (b) either (i) is used (or is intended to be used) as a medium of exchange accepted by the public as payment for goods or services, or for the discharge of debt,

[125] The Conclusions are available here.

or for investment purposes; or (ii) provides rights, eligibility or access to vote on the management, administration or governance of the affairs in connection with any cryptographically secured digital representation of value; (c) can be transferred, stored or traded electronically; and (d) satisfies other characteristics prescribed by the SFC. Notably, the SFC clarified that while the definition does not explicitly cover non-fungible tokens (**NFTs**), depending on the terms and features of the specific NFT, such NFT may be caught by the definition of VA.

The Conclusions provided clarification in four key areas:

1. Scope of VA platform's offerings

- The SFC's view is that a VA Platform's primary business is to act as an agent and match client orders.
- VA Platforms can offer services to retail investors (however, there are restrictions on offering security tokens to retail investors).
- VA Platforms cannot offer or trade in VA derivatives – the SFC is aware of the importance of VA derivatives to institutional investors given the large number of comments made on its original consultation in relation to the same. The SFC will conduct a separate review of VA derivatives in due course.
- VA Platforms cannot provide staking, deposit-taking, lending nor borrowing services as these may lead to potential conflicts of interest.
- VA Platforms cannot conduct proprietary trading or algorithmic trading. However, the VA Platform's clients can use their own algorithmic trading systems in connection with trading via the VA Platform.

2. Listing of tokens

- A VA Platform must conduct due diligence on each token[126] before the token can be listed on the VA Platform. There are no exemptions from such due diligence requirement even if the token is listed on another licensed VA Platform.
- Token-specific information must be disclosed by the VA Platform and, accordingly, the SFC expects the VA Platform to exercise due skill, care and diligence in selecting VAs to be made available for trading on the VA Platform and in ensuring that the disclosures in relation to each token listed on the VA Platform are not false, biased, misleading or deceptive.
- VA Platforms can rely on smart contract auditing conducted by an independent assessor.
- Non-security tokens need to have at least a 12-month track record prior to listing.
- Tokens to be made available for retail trading must be eligible large-market capitalisation tokens.[127] The SFC will not publish a whitelist of acceptable tokens or acceptable indices, but will refer to the International Organization of Securities Commission's (**IOSCO**) Principles for Financial Benchmarks. For security tokens, as they cannot be offered for retail trading, such requirement is not applicable.

Note: Relevantly to private fund managers, this would provide a channel for private fund managers to tokenise their funds and list their security tokens on VA Platforms.

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[126] "Token" means any non-security token and any security token.

[127] In the VATP Guidelines, a token available for trading by retail investors must be included in at least two acceptable indices issued by at least two independent index providers (one of which must comply with IOSCO's Principles for Financial Benchmarks and have experience in publishing indices for the conventional securities market).

For the purposes of the VATP Guidelines, an "acceptable index" means an index that has a clearly defined objective to measure the performance of the largest virtual assets in the global market. Such index must fulfil the following criteria: (a) the constituent virtual assets should be sufficiently liquid; (b) it should be objectively calculated and rules-based; (c) the index provider should the necessary expertise and technical resources to construct, maintain and review the methodology and rules of the index; and (d) the methodology and rules of the index must be well documented, consistent and transparent.

- The SFC does not require a VA Platform to seek and submit to the SFC external legal advice confirming that each token made available for retail trading would not amount to a security token. However, the SFC may request legal opinions in relation to specific tokens taking into account developments in other jurisdictions. VA Platform operators are nonetheless reminded of their obligations and to take reasonable steps to ensure that retail trading of any token they make available will not breach the public offering regimes in Hong Kong.
- Until stablecoin regulatory arrangements have been implemented, stablecoins are not available for retail trading. A more holistic regulatory regime on stablecoins will be announced by Hong Kong Monetary Authority.

3. Insurance and compensation arrangement

- The Conclusions relaxed the insurance/compensation coverage requirements for VAs in cold storage – a minimum 98 percent of client VAs need to be held in cold storage, with 50 percent insurance/compensation coverage. Other compensation mechanisms may also be acceptable.
- A maximum two percent of client VAs in hot or other storage, with 100 percent insurance/compensation coverage. This has not changed since the consultation.
- All seeds and private keys need to be securely stored in Hong Kong, with appropriate certification such as Hardware Security Module.

4. Licence related matters

- In the Conclusions, the SFC suggests that it would be prudent for VA Platforms to be licensed under each of the respective regimes under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (SFO) and the AMLO.[128] The SFC will adopt a streamlined single application process for the dual licensing regime and will allow the proposed responsible officers of a VA Platform to be approved both under the SFO and the AMLO so that it will not be necessary for a dual-licenced VA Platform to maintain four responsible officers.

6.2 Retail Security Token Offerings

In the Fintech Week Keynote, Ms. Leung commented that security token offerings (**STOs**) have been gaining traction among traditional financial institutions, including the tokenization of traditional financial instruments, such as debt securities and units in collective investment schemes. Ms. Leung stated that the SFC will be issuing a circular setting out the requirements applicable to STOs and the listing of STOs, which will largely mirror the existing SFC regime for traditional securities offerings. Ms. Leung also noted that, where the security token is a digital representation of a traditional security but is issued or traded on a blockchain, the security token will be treated the same way as the existing underlying traditional security in terms of regulatory status. This means that the security token will no longer be a "complex product" solely because it is issued or traded on blockchain. If, however, the tokenization process leads to additional features that make the security token "complex", then such security token will be regarded as a "complex product", and distribution will be restricted to professional investors only.

In addition, the SFC expects distributors who distribute security tokens to perform reasonable due diligence and conduct smart contract audits before the security tokens are distributed. These new regulations, together with the modified requirements for listing security tokens on licensed virtual asset exchanges, will be addressed in the upcoming SFC circular.

[128] This refers to the licence to conduct Type 1 regulated activity (dealing in securities) and Type 7 regulated activity (providing automated trading services) under the SFO and the licence for virtual asset service provider under the AMLO.

6.3 Virtual Asset Futures Exchange Traded Funds

Given the rapid development of the virtual asset market and the increased availability of virtual asset products to both professional and retail investors globally, the SFC has accepted applications for authorisation of virtual asset futures exchange traded funds (**VA Futures ETFs**) that will be available to retail investors upon authorisation.

On 31 October 2022, the SFC published a circular on VA Futures ETFs[129] (**ETF Circular**), that sets out requirements for VA Futures ETFs that are seeking SFC authorisation for public offering, in addition to the requirements set out in Chapters 7 and 8 of the SFC's Code on Unit Trust and Mutual Funds (**UT Code**). The main additional requirements in the ETF Circular include:

- ***Eligible management company***: The management company of the VA Futures ETF must have a good track record of regulatory compliance, and a proven track record in managing ETFs of at least three years. The relevant experiences in managing the same or similar type of products (i.e., virtual asset related products) from the group of companies to which the management company belongs will be taken into account. The SFC may consider, on a case-by-case basis, whether they will accept a delegation or co-management arrangement;
- ***Eligible futures***: The VA Futures ETF must only invest in futures contracts that are listed and traded on conventional regulated exchanges, currently confined to Bitcoin futures and Ether futures traded on the Chicago Mercantile Exchange. The SFC may further expand the scope of eligible futures in the future upon further review; and
- ***Investment strategy****:* The VA Futures ETF must adopt an active strategy that allows flexibility in portfolio management and describes its strategy in the event of rolling of futures contracts and market disruptions. The net derivative exposure (as in defined in the UT Code) must not exceed 100% of the VA Futures ETF's total net asset value.

6.4 Management and Disclosure of Climate-related Risks of Fund Managers

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

The Climate Risk Requirements reflect the SFC's findings – as set out in the SFC circular dated March 2019 on the Survey on Integrating Environmental, Social and Governance Factors and Climate Risks in Asset Management – that climate-related risks are a source of financial risk that need to be considered and managed by Fund Managers.[130]

The Climate Risk Requirements took effect from 20 November 2022 for all Fund Managers.

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

Implementation timeline: Large Fund Managers[131] should have complied with the Baseline Requirements by 20 August 2022, and will have to comply with the Enhanced Requirements by 20 November 2022. Fund Managers who are not Large Fund Managers should have complied with the Baseline Requirements by 20 November 2022.

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[129] The ETF Circular is available here.

[130] **Fund Managers** are defined as "Type 9 (asset management) licensed corporations that exercise discretionary investment management over the assets of investment fund(s)".

[131] **Large Fund Managers** are defined in the Conclusions as Fund Managers with assets under management (AUM) of HK$8 billion or above for any three months during the preceding 12 months (exclusive of AUM from discretionary accounts).

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

6.5 Cryptocurrency Recognised as "Property"

In *Re Gatecoin Limited* [2023] HKCFI 91, the Hong Kong court held that cryptocurrency exhibits all the characteristics of property and could be held on trust in the context of a liquidation. However, the cryptocurrencies in question were ultimately not held on trust.

Background

Gatecoin Limited (**Gatecoin**), a Hong Kong-based cryptocurrency exchange platform, was wound up in 2019. Over 50 types of cryptocurrencies valued at over HK$140 million were recovered by the liquidators. Customers were classified into different groups based on the terms and conditions they agreed to.

Cryptocurrency as Property

The court had to determine whether cryptocurrencies were a form of property that could be held on trust. The court examined the statutory definition of "property" pursuant to section 3 of the Interpretation and General Clauses Ordinance (Cap. 1); as well as the criteria outlined by Lord Wilberforce in *National Provincial Bank v Ainsworth* [1965] 1 AC 1175 (*Ainsworth*), which include being "definable, identifiable by third parties, capable in its nature of assumption by third parties, and having some degree of permanence or stability". The court also reviewed the approach taken by various common law jurisdictions, and ultimately relied on the New Zealand High Court decision of *Ruscoe v Cryptopia* [2020] NZHC 728, which held that the definition of property is broad enough to include cryptocurrency, even if it cannot be strictly classified as either a chose in possession or a chose in action. The court found that cryptocurrency met the criteria outlined by Lord Wilberforce in *National Provincial Bank v Ainsworth* [1965] 1 AC 1175, and relied on the following reasoning in reaching its decision:

"*(1) It is definable as the public key allocated to a cryptocurrency wallet is readily identifiable, sufficiently distinct and capable of being allocated uniquely to individual account holder (§§104-108).*

(2) It is identifiable by third parties in that only the holder of a private key is able to access and transfer the cryptocurrency from one wallet to another (§§109-113).

(3) It is capable of assumption by third parties in that it can be and is the subject of active trading markets where (a) the rights of the owner in that property are respected, and (b) it is potentially desirable to third parties such that they want themselves to obtain ownership of it (§§114-116).

(4) It has some degree of permanence or stability as the entire life history of a cryptocurrency is available in the blockchain (§§117-119)".

Accordingly, the court concluded that cryptocurrencies were a form of property that could be held on trust.

Holding on Trust

The court then examined whether Gatecoin had held the cryptocurrencies on trust for its customers. The "three certainties" (subject matter, object, and intention) were considered. The court found that the certainty of subject matter and object were fulfilled, but the certainty of intention was not. The court held that all the customers must have agreed to the terms and conditions effective from 6 March 2018 to 13 March 2018 to continue accessing the Gatecoin platform, which expressly disclaimed a trust arrangement. As a result, all three groups of customers were found to have contractual claims against Gatecoin, rather than proprietary claims over the cryptocurrencies.

Key Takeaways

This case demonstrates Hong Kong courts' efforts to fit cryptocurrencies into the framework of traditional property law by applying existing legal principles. Although cryptocurrencies may not fit neatly within the traditional

classification of "property," they possess characteristics of intangible property similar to stocks and shares, as reflected in their treatment in this case.

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