# Upcoming Regulatory Initiatives Impacting Private Fund Managers

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April 2021 / Authored by Karen Anderberg, Gus Black, Katie Carter, Fiona Chandler, Richard Frase, Christopher Gardner, Philippa List, Mark Stapleton, Karen Stretch, Lindsay Trapp and Simon Wright

## 1. ESG

In recent years, environmental, social and governance (**ESG**) factors have become a key discussion point in the asset management industry, with many managers now incorporating ESG considerations into their investment processes. It is a topic that continues to gain global importance. In the EU, the impetus stems primarily from the EU Sustainable Finance Action plan and remains on the top of the regulatory agenda. There have been some key developments taking the form of new legislation and amendments – proposed and actual – to existing legislation.

Of most significance are the Sustainable Finance Disclosure Regulation (**SFDR**) and the Taxonomy Regulation which impact "Financial Market Participants" (**FMPs**) (which includes amongst others AIFMs, UCITS ManCos, Portfolio Managers/Advisors) in relation to "Financial Products" (which includes amongst others AIFs, UCITS and segregated investment management mandates).

The SFDR, which took effect on 10 March 2021, impacts both firms and products and requires three types of disclosure – website disclosure, pre-contractual disclosure and periodic reporting. It requires FMPs to make significant changes to their pre-March 2021 processes.

There were, and remain, challenges to meeting the requirements of the SFDR. The SFDR included provisions requiring the European Supervisory Authorities (**ESAs**) to prepare level 2 regulatory technical standards (**RTS**) to provide further detail and to assist in the application of the SFDR provisions before 30 December 2020. However, in October 2020, the EU Commission announced that the RTS would not apply on 10 March 2021 but would apply at a "later stage." (See our OnPoint on the delay, available here.

On 4 February 2021, the ESAs published a final report on the RTS, which proposed changes to the original draft RTS that were published in April 2020 (the **Revised RTS**), available here. On 25 February 2021, the ESAs issued a Supervisory Statement on the application of SFDR, which confirmed the delay of the application of the SFDR RTS and proposed an application date of 1 January 2022, which is the date on which the Taxonomy Regulation takes effect.[1] The ESAs' letter also included a summary table setting out the effective dates of the SFDR and Taxonomy Regulation disclosure obligations and recommended that national competent authorities encourage FMPs to use the period from 10 March 2021 until 1 January 2022 to prepare for the application of the RTS.

On 7 January 2021, the ESAs wrote to the EU Commission highlighting that they had encountered several important areas of uncertainty in the interpretation of SFDR and asked for clarification on a number of points. At the time of writing, the EU Commission has not responded to the ESAs' request for guidance. See Dechert's OnPoint "Preparing for SFDR" for more details on the Letter from the ESAs to the EU Commission," available here.

The go-live of SFDR on 10 March 2021 did not see an end to European ESG related developments. On 15 March 2021, the ESAs issued a consultation paper that proposed further amendments to the Revised RTS that were published in February 2021. The amendments to the Revised RTS set out in the consultation paper address

[1] The ESAs' Supervisory Statement is available here.

the level 2 disclosures that the ESAs are mandated to draft pursuant to the provisions of the Taxonomy Regulation. These Taxonomy-related RTS deal with additional disclosures for Article 8 and Article 9 financial products making use of the environmental taxonomy. The rationale for amending the Revised RTS instead of creating a new rule set, was to minimise duplication and complexity in this area. In consideration of the 1 June 2021 deadline for delivery of the SDFR RTS, the ESAs have provided for an eight-week consultation period (closing on 12 May 2021) instead of the usual three months. The ESAs anticipate that they will issue a final report with draft RTS – covering both the SFDR and Taxonomy Regulation - by late June or early July 2021.

Additional regulatory developments in the ESG space include the EU Commission announcing, on 21 April 2021, that they had adopted delegated acts that propose amendments to MiFID II (product governance/organisational requirements), to the UCITS Directive and to AIFMD. The EU Commission had previously consulted on the delegated legislation in June 2020. The Council of the EU and the European Parliament are to consider the legislation, with the delegated directives due to apply 12 months after they enter into force.

In addition, following consultations 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**), which would amend reporting requirements contained in NFRD. CSRD aims to ensure consistency between reporting requirements contained in the Taxonomy Regulation and company sustainability reporting.

Additional rules and regulations relating to sustainable development take the form of the EU Ecolabel framework for certain financial products and Green Bond Standards, proposals for a European Climate Law which aims to write the EU's climate neutrality target into binding legislation, together with local developments such as the AMF's ESG-related Doctrine.[2] The EU also enacted the Low Carbon Benchmark Regulation which entered into force in December 2019. The Low Carbon Benchmark Regulation amended the EU Benchmarks Regulation by introducing two new types of "climate benchmark," which seek to ensure the integrity of low-carbon benchmarks.

BREXIT – SFDR was not 'on-shored' in the UK as a piece of existing EU legislation following the end of the Brexit transition period (which was 11.00 p.m. on 31 December 2020), and it remains to be seen if and how far the UK's position will diverge from the EU's. The UK government has stated that "*at the very least, we will match the ambition of the EU Sustainable Finance Action Plan*." The UK was one of the first countries worldwide to endorse the recommendations of the Task Force for Climate-related Financial Disclosures (**TCFD**) – aimed at ensuring climate-related risks and opportunities are priced into financial decision-making, and its 2019 Green Finance Strategy outlined an expectation that all UK listed issuers and large asset owners would be making disclosures in accordance with the TCFD's recommendations by 2022.

The UK continues to develop its own post-Brexit regulatory and legislative agenda with the Financial Conduct Authority (**FCA**) and HM Treasury launching a number of initiatives. On 9 November 2020, HM Treasury published an Interim Report of the UK's Joint Government-Regulator TCFD Taskforce (the **Report**) and a Roadmap (the **Roadmap**) which provide an outline of the UK's ambitions on climate change mitigation. The UK Taskforce describes itself as *"charting a path towards mandatory TCFD-aligned climate-related disclosures to help accelerate progress*." The Roadmap sets out an indicative path for the introduction of regulatory rules and legislative requirements over the next five years. The Report also sets out the implementation approach for Asset Managers. (See Dechert's OnPoint "Is Brexit Green? A UK Roadmap Towards Mandatory Post-Brexit Climate-Related Disclosures," available here).

On 24 March 2021, the UK's Department of Business, Energy and Industrial Strategy published a consultation paper seeking views on proposals to mandate climate-related financial disclosures by publicly quoted companies,

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

large private companies and LLPs in relation to financial periods beginning on or after 6 April 2022. The stated objective of these disclosures is "*to increase the quantity and quality of climate-related financial disclosures in a proportionate manner. This is both to ensure market participants have better information to adequately understand climate-related financial risks and opportunities to support the transition to net zero, but also to help companies think about what they need to do to address climate change as an important risk and opportunity for their organisation, operations and people.*"[3] The consultation closes on 5 May 2021.

On 13 April 2021, Nausicaa Delfas, FCA Executive Director of International, gave a speech where she said that the FCA intends to consult by mid-2021 on proposals for disclosures aligned with the recommendations of the TCFD by asset managers, life insurers and FCA-regulated pension providers.

On 19 April 2021, the FCA published a press release announcing the appointment of a new sustainability director. This is a new role which will see the director develop the FCA's approach to sustainable finance domestically and internationally. The role is part of the measures introduced to fulfil the government's commitment to achieve a net-zero economy by 2050.

Further details have yet to be announced.

## 2. LIBOR

Focus remains on the transition away from the London Interbank Offered Rate (**LIBOR**), a key interest rate benchmark that is referenced across many of the agreements that you, funds you manage or advise or entities that you have invested in, have entered into. The end of 2021 remains a critical date for LIBOR cessation – being the date after which the FCA will no longer compel panel banks to contribute submissions to the administrator of LIBOR, ICE Benchmark Administration (**IBA**), for determining the majority of LIBOR tenors.

Whilst the UK is the home of LIBOR, this is a multi-currency, international issue as LIBOR is published in five currencies: USD, GBP, Euro, CHF and JPY. Alternative largely risk-free interest rates (the **RFRs**) have been identified as replacements for each of the LIBOR family of currencies: SONIA (GBP), SOFR (USD), SARON (CHF), €STR (EURO) and TONA (JPY).

Many regulators see the transition from LIBOR as a financial stability risk given the prevalence of LIBORs use across a multitude of agreements. Exposures to LIBOR can arise at every level of a business – investments, loans, hedges, fees, systems and infrastructure. The disruption caused by the COVID-19 pandemic did little to slow the pace of transition efforts and achieving a smooth transition away from LIBOR benchmarks by 31 December 2021 remains a priority for the FCA and other regulators.

The FCA continues to prioritise the transition away from LIBOR and market participants are actively being encouraged, and indeed incentivised, to move to alternative risk free rates. In the UK these efforts are being led by the Working Group on Sterling Risk-Free Reference Rates (**WGRFR**), the FCA and the Bank of England, and in the U.S. by the Alternative Reference Rates Committee (**ARRC**). There has also been significant input from industry associations, in particular ISDA (as the vast majority of LIBOR exposure lies in derivatives products) and also the Loan Market Association.

**Changes to the regulation of benchmarks**

In relation to the regulation of benchmarks, on 23 June 2020 the UK government declared its intention to change the UK Benchmarks Regulation to permit changes to the methodology for determining LIBOR rates with a view to

[3] Page 8 of the Consultation on BEIS mandatory climate related disclosure requirements (click here)

enabling LIBOR to continue to be used as a benchmark in certain limited circumstances. The FCA webpage explaining the extent of the proposals is available here. There was also a Summer 2020 proposal from the EU Commission to amend the EU rules on benchmarks to empower the EU Commission to designate a replacement benchmark that covers all references to widely used reference rates such as LIBOR when this is necessary to avoid a disruption of the financial markets. The amending regulation was published in the EU Official Journal (**OJ**) on 10 February 2021.[4]

On 21 October 2020, the Financial Services Bill (the **FS Bill)** was introduced to the House of Commons and included several significant provisions relating to benchmarks. On the same date, HM Treasury published a LIBOR policy statement to accompany the FS Bill. The FS Bill received Royal Assent on 29 April 2021 and is now law, being referred to as the Financial Services Act 2021 (the **FS Act** see Section 5.1).

At a high level, the FS Act will make significant amendments to the current benchmarks regulation and greatly expand the FCA's powers. The FS Act amends the UK Benchmarks Regulation, providing an overarching legal framework which gives the FCA new and enhanced powers to manage the wind-down of a critical benchmark. The FS Act expands the circumstances in which the FCA can conduct a formal assessment of a benchmark's representativeness and also grants the FCA powers to prohibit some or all use of a specific benchmark by supervised entities. The FCA consulted on their proposals in November 2020 and is now in the process of setting out its final policy on (i) designating an unrepresentative benchmark using new powers under Article 23A of the UK Benchmarks Regulation introduced by the FS Act and (ii) requiring changes to a critical benchmark, including its methodology, using new powers under Article 23D of the UK Benchmark Regulation also introduced by the FS Act. The FCA plans to consult in Q2 of 2021 on their approach to the exercise of powers under Article 21A and Article 23C of the UK Benchmarks Regulation. Further consultations will also be conducted in 2021 in relation to any decision to exercise the Article 23D power in respect of LIBOR. Exact timing remains unknown – the new amendments to the UK Benchmarks Regulation will only come into force on the day designated by HM Treasury pursuant to Section 49(5) of the FS Act and that commencement date has not yet been announced.

**Where we got to in 2020 and new for 2021**

Significant LIBOR developments came late in 2020 with a series of announcements by the IBA. The most notable was the IBA announcement[5] that it would consult in early December 2020 on ceasing publication of the one-week and two-month USD LIBOR settings immediately after the LIBOR publication on 31 December 2021, and the remaining USD LIBOR settings immediately after the LIBOR publication on 30 June 2023. In 2021, LIBOR transition remains a regulatory priority. On 5 March 2021:

- The IBA published the feedback statement on the results of its December 2020 consultation, including an announcement that, in the absence of sufficient panel bank support and without the intervention of the FCA to compel continued panel bank contributions to LIBOR, it would not be possible for the IBA to publish the relevant LIBOR settings on a representative basis beyond 31 December 2021 or 30 June 2023.

- The FCA published a statement announcing the dates after which panel bank submissions for all LIBOR settings will cease and confirming the future cessation and loss of representativeness of all LIBOR settings. The FCA announcement covered a range of LIBOR-related items including links to Statements of Policy with respect to its exercise of future powers, so called "Article 23A" and "Article 23D" powers,

[4] EU Regulation 2021/168 amending Regulation (EU) 2016/1011 as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements for certain n benchmarks in cessation, and amending Regulation (EU) No 648/2012 is available here.

[5] See ICE website, section entitled "The Future of LIBOR" for full details on the IBA November announcements and the December IBA consultation, available here.

included in the FS Act. This FCA statement officially confirms the end of LIBOR across all currencies and tenors.

ISDA[6] confirmed that the FCA's announcement constitutes "an index cessation event under the IBOR Fallbacks Supplement and the ISDA 2020 IBOR Fallbacks Protocol for all 35 LIBOR settings." This means that the fallback spread adjustment published by Bloomberg is fixed as of 5 March 2021 for all euro, sterling, Swiss franc, U.S. dollar and Japanese yen LIBOR settings (including for the U.S. dollar LIBOR settings that will be published until June 2023).

Although publication of USD LIBOR will continue on a representative panel bank basis until the end of June 2023, it is not to be used in new contracts. The remaining USD LIBOR tenors are only for use in legacy contracts, and for managing legacy LIBOR risk. There is a clear expectation that use of USD LIBOR in new contracts should stop by the end of this year, in the U.S. and in other key jurisdictions.[7] The Federal Reserve's Vice Chair for Supervision was emphatic when delivering a speech on 22 March 2021 – "there should be complete certainty about this guidance from U.S. regulators: after 2021, we believe that continued use of LIBOR in new contracts would create safety and soundness risks, and we will examine bank practices accordingly." He also stated that "there is no scenario in which a panel-based USD LIBOR will continue past June 2023, and nobody should expect it to."[8] The Vice Chair also confirmed that Federal Reserve Board examiners have been instructed to assess supervised institutions' plans to transition away from the use of LIBOR and if they are not making adequate progress, examiners should consider issuing supervisory findings or taking other supervisory actions.

Most recently, on 26 March 2021, the PRA and the FCA published a joint "Dear CEO letter" on the transition from LIBOR to RFRs.[9] The letter sets out a list of priority areas where further action by firms is necessary to prepare for the cessation of LIBOR. Key points in the letter include:

- Cessation of new sterling LIBOR business milestones - from 1 April 2021, the regulators do not expect to see incremental sterling LIBOR loan, bond, securitisation or linear derivatives business being written by PRA and FCA regulated firms and groups, unless specifically permitted within the RFRWG milestones. The regulators warn that any incident of sterling LIBOR referencing loan, bond or securitisation issuance after that date that expires beyond the end of 2021 would potentially be viewed as indicative of poor risk management and poor governance of transition.

- Active transition of legacy LIBOR exposures – the regulators expect firms to intensify efforts to execute plans to transition the stock of legacy LIBOR-linked contracts before the confirmed cessation dates of LIBOR, wherever it is feasible to do so. All legacy sterling LIBOR contracts should, wherever possible, have been amended by the end of Q3, 2021 to include at least a contractually robust fallback that takes effect upon an appropriate event, or, preferably, an agreed conversion to a robust alternative reference rate.

The PRA and FCA confirmed that they are intensifying supervisory focus on firms' management and oversight of the risks associated with transition.

The message remains the same – the time to act is now.

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[6] For more details on the ISDA Supplement and Protocol, please see our OnPoint "LIBOR Transition – The Moment the Market has Been Waiting For," available here.

[7] Stated in a speech given by Edwin Schooling Latter, the FCA's director markets and wholesale policy, on 13 April at the ISDA Benchmark Strategies Forum.

[8] Stated by Randal K. Quarles in his Keynote Speech on 22 March at "The SOFR Symposium: The Final Year," hosted by the ARRC, available here.

[9] The joint FCA and PRA Dear CEO letter can be accessed here.

We have a range of LIBOR resources available. Our most recent round-up on LIBOR is available here.

Our dedicated Dechert LIBOR site is available here and includes information on future update webinars and broadcasts. Details of our next LIBOR update webinar will be released shortly. Our LIBORcast podcast series includes discussions with key players such as ISDA, the FCA, and Fitch Ratings. The full LIBORcast series is available here.

## 3. BREXIT

The UK formally left the EU at 11.00pm on 31 January 2020, and the UK and the EU entered the withdrawal agreement's "transition period" which was designed to maintain the regulatory status quo between the UK and the EU until 11.00 p.m. on 31 December 2020. During the transition period, EU law continued to apply to and in the UK, and the UK was treated as part of the EU's single market in financial services – meaning that, until 31 December 2020, UK financial services firms were able to access EU markets on the same terms and with the same rights and protections as before the withdrawal.

On 24 December 2020, the EU and the UK agreed the terms of a Trade and Cooperation Agreement (the **TCA**), which, broadly speaking, establishes a customs and duty-free border between the UK and the EU together with a framework for encouraging trade between the UK and the EU, based on the concept of a level playing field for matters such as monopolies, subsidies, and protectionism.

The TCA does not cover any decisions on equivalence for financial services. Agreement in this area was always recognised as highly ambitious, and its omission from the TCA is not seen as surprising. The UK and EU also issued, at the same time as the TCA, a "Joint Declaration on Financial Services Regulatory Cooperation between the European Union and the United Kingdom" which provides that the parties will aim to agree, by March 2021, a Memorandum of Understanding (**MoU**) establishing a framework for regulatory cooperation on financial services. While this is positive, the MoU does not have the same legal force as an international treaty and, although it may provide some limited assurances to financial market participants, it does not provide certainty for firms trying to make long-term strategic plans. (See Dechert's OnPoint "A New European Financial Services Landscape for a New Year?" available here.)

On 26 March 2021, the UK's HM Treasury published a press release[10] announcing that technical discussions on the text of the MoU on UK-EU regulatory co-operation in financial services have concluded. The press release confirmed that formal steps need to be undertaken on both sides before the MoU can be signed but that it expects that this can be done expeditiously. At the time of writing, the text of the final version of the MoU has not yet been published.

The absence of details of an agreement on financial services means that, from 11.00pm GMT on 31 December 2020, the challenges facing financial services firms are effectively the same as those which would have been faced in a "no deal" Brexit. UK firms accessing EU markets, and EU firms accessing UK markets, can no longer continue to rely on the passporting rights which existed prior to 31 December 2020.

The UK government and the FCA have implemented a Temporary Permissions Regime (**TPR**) for "inbound" European Economic Area (**EEA**) firms and a Temporary Marketing Permissions Regime (**TMPR**) for "inbound" EEA funds which took effect on 1 January 2021. The FCA required firms and fund managers wanting to use the TPR or the TMPR to notify the FCA before 30 December 2020.

[10] The HM Treasury press release is available here.

The TPR allows EEA-based firms and funds that were passporting into the UK at the end of the transition period (i.e. 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. The TMPR allows certain EEA-based funds that were passporting into the UK at the end of the transition period to continue to be marketed in the UK in the same manner as they were before the transition period ended (again, subject to having notified the FCA before the end of the transition period).

Firms and funds that have not submitted their notifications are not able to use the TPR or TMPR respectively. However, if new sub-funds of EEA UCITS are authorised by the relevant home state regulator after the end of the transition period, and form part of an umbrella scheme that had notified for the TMPR before the end of the transition period, they may be added into the TMPR so that they can be marketed to the general public including retail investors.

Looking to the future of UK financial services regulation, the UK government is working on a new post-Brexit regulatory framework for financial services (referred to as the Future Regulatory Framework). HM Treasury published a consultation paper in October 2020, covering matters such as how regulators should deal with technical standards, how policy innovation from HM Treasury and Parliament will be scrutinised, and how that will interact with regulators' responsibilities. The deadline for responses was 19 February 2021. This will be followed by a second consultation, to be published in the first half of 2021 that will set out more detail on the proposed approach.

The Financial Services Act (the **FS Act** – see Section 5.1), is an omnibus piece of legislation that amends many elements of the UK's financial services legislative framework following the UK's departure from the EU, received Royal Assent on 29 April 2021 and is now law. The FS Act, among other things, establishes the legislative framework for:

(i) an Overseas Funds Regime (**OFR**) under which overseas collective investment schemes may be allowed to be marketed to UK investors, including retail investors, on appropriate terms and

(ii) the Investment Firms Prudential Regime (**IFPR**) which will largely replace the existing prudential requirements for FCA MiFID investment firms.

In terms of other developments, on 26 January 2021 the HM Treasury launched a review of the UK funds regime. HM Treasury's intention is to identify options which will make the UK an attractive location to set up, manage and administer funds. (See Section 5.3 below for more details).

## 4. EUROPEAN REGULATORY INITIATIVES

### 4.1 AIFMD Marketing/Pre-marketing – Cross-border distribution of investment funds

Changes to EU law on the cross-border distribution of AIFs and UCITS will come into effect on 2 August 2021. UK AIFMs will be out of scope of the majority of these new rules, as they only apply to EU AIFMs marketing EU AIFs. The changes are made by way of a Regulation ((EU) 2019/1156) and a Directive ((EU) 2019/1160)) and are commonly referred to as the CBDF framework – which forms part of the EU's capital markets union initiative. (See Section 4.3 below).

The changes introduce a definition of and conditions for pre-marketing of EU AIFs by EU AIFMs. National private placement regimes will continue to apply to marketing by non-EU AIFMs and the new pre-marketing rules will not apply to non-EU AIFMs. Conditions and de-notification requirements will also apply when marketing of an AIF / UCITS by an EU AIFM or ManCo ceases in a particular EU member state.

All AIFMs will have to establish certain local facilities when marketing to retail investors. The facilities will not however need to be a physical presence in a country and may be run by a third party.

From 2 August 2021, marketing materials for AIFs and UCITS must be identifiable as such and must describe the potential risks and rewards of purchasing units or shares in UCITS/AIFs in an equally prominent manner and all information included in marketing communications must be fair, clear and not misleading.

ESMA published a consultation paper on 9 November 2020 on draft guidelines for funds' marketing communications under Article 4 of the Regulation. The purpose of the draft guidelines is to specify the requirements for marketing communications sent to investors to promote UCITS and AIFs (including EuSEFs, EuVECAs and ELTIFs). ESMA will issue the final marketing guidelines by 2 August 2021 and the EU Commission is also to report on reverse solicitation under the cross-border distribution of funds (CBDF) framework by the same date.

By 2 February 2022 ESMA is to develop draft implementing technical standards with standard forms, templates and procedures under the CBDF framework, having issued a consultation paper on the standards in March 2020.

### 4.2 Further AIFMD developments

**EU Commission review of AIFMD**: The EU Commission's wide-ranging consultation on the review of the application and scope of AIFMD launched in October 2020 and closed to comments in January 2021. The consultation aimed to examine how to strengthen the rules and complete the internal market for AIFs. The EU Commission is expected to adopt a legislative proposal amending AIFMD and/or other parts of the AIFMD framework in Q3 of 2021, which could also lead to further harmonising amendments to the UCITS rules. Industry comments on the consultation were that substantial changes are not required to the AIFMD itself and any amendments should instead be made to the AIFMD framework legislation / guidance.

In December 2020 a speech by ESMA's executive director in the context of the AIFMD review, focused in particular on delegation under AIFMD. ESMA's view is that all AIFs should be subject to consistent regulatory standards regardless of status or location of the delegates, especially with delegation to non-EU entities that may be subject to different regulatory standards.

On 17 March 2021, the French financial services regulatory authority, the Autorité des Marchés Financiers (**AMF**) published a set of recommendations to change the AIFMD and UCITS regime as part of an ongoing review of AIFMD.[11] The recommendations include proposals regarding the use of the management passport, delegation, reporting and liquidity management tools, as well as consistency between the AIFMD, UCITS and MIFID directives. In relation to delegation, the AMF – while acknowledging the benefits of delegation - believes certain delegation models should be further scrutinized to ensure AIFMs and UCITS managers remain ultimately in charge of key business functions and decisions.

Delegation is likely to be a hot topic following the end of the Brexit transition period and now that UK investment managers are non-EU entities under AIFMD.

Leverage risk: on 17 December 2020 ESMA published its final report containing guidelines to address leverage risk. This followed on from an ESMA consultation paper issued in March 2020 on how the leverage-related systemic risk assessment should be conducted and when leverage limits might be imposed. The guidelines follow IOSCO's two step approach and include a set of indicators for National Competent Authorities to consider when performing their risk assessment plus a set of principles for them to take into account when setting

[11] The AMF's 17 March 2021 recommendations are available here.

leverage limits. The guidelines are due to apply later in 2021, two months after publication of their translation into the official EU languages.

### 4.3 Capital Markets Union Action Plan

The EU Commission published its second action plan on the Capital Markets Union in September 2020. The action plan includes 16 initiatives grouped under 3 objectives which the EU Commission is working on:

- Supporting a green, inclusive and resilient economic recovery by making financing more accessible to European companies
- Making the EU a safer place for individuals to save and invest long-term
- Integrating national capital markets into a genuine single market

As part of this ongoing initiative to strengthen EU capital markets, in December 2020 the Council of the EU approved prioritising those actions that are important for improving the funding of the economy and SMEs in particular and that have the potential to support a swift economic recovery in the context of the COVID-19 pandemic. These should be delivered by the EU Commission no later than the end of 2021.

### 4.4 CSDR

The new settlement discipline regime requirements under the Central Securities Depositories Regulation (**CSDR**) have been delayed until 1 February 2022 due to the disruption caused by the COVID-19 pandemic. The UK government announced in June 2020 that it would not be implementing the CSDR settlement discipline regime in the same form in the UK, following Brexit.

In March 2021, the EU Commission published a roadmap on its review of CSDR and its implementation. The EU Commission's webpage indicates that it intends to propose legislation in Q1 2022 to simplify CSDR and develop a more integrated post-trading landscape. Focus remains on the settlement discipline regime, in particular the new mandatory buy-in rules. In March 2021 a group of industry associations sent a letter[12] to the EU Commission and ESMA highlighting concerns in the area. ELTIF Reform

The EU Commission launched a consultation on the review of the European Long-term Invest Fund (**ELTIF**) Regulation in October 2020. The consultation closed for comments in February 2021 and sought views on:

- the scope of the ELTIF authorisation and process
- investment universe, eligible assets and qualifying portfolio undertakings
- borrowing of cash and leverage
- conflict of interest and co-investment
- rules on portfolio composition and diversification

On 3 February 2021, ESMA published its letter to the EU Commission setting out areas where ESMA considers the ELTIF Regulation could be improved and its proposed changes to the regulation.

[12] A copy of the letter is available here.

The EU Commission is expected to adopt a report on its review of the ELTIF Regulation in Q3 of 2021, which also forms part of its work under the Capital Markets Union Action Plan.

Proposals to reform the ELTIF structure are gaining industry support, to make it more attractive to professional investors and as a way of engaging retail investors in long term investments for the economic recovery from the COVID-19 pandemic.

### 4.5 EMIR

**Regulatory reporting.** The December 2020 ESMA final report on new draft implementing technical standards for reporting under the European Markets and Infrastructure Regulation (**EMIR**) remains under consideration by the EU Commission. The report includes the proposal that an 18 month implementation period should apply. This report followed a consultation earlier in 2020 on Technical Standards on reporting, data quality, data access and registration of trade repositories pursuant to EMIR, as amended by the EMIR Refit Regulation and the reporting responsibility changes introduced by the EMIR Refit Regulation which took effect on 18 June 2020. The draft technical standards set out in ESMA's report are currently being considered by the EU Commission and, if adopted, ESMA has proposed an 18 month implementation period.

On 12 April 2021 the EU Commission published a report on whether trades that directly result from post-trade risk reduction services should be exempted from the clearing obligation for OTC derivatives under EMIR, proposing further work on this area as part of its general review of EMIR.

**Initial margin.** Phase 5 of the EMIR regulatory initial margin requirements will take effect on 1 September 2021. Entities in scope will have an aggregate average aggregate notional amount, so called "AANA" threshold of EUR 50bn by reference to March, April and May 2021. Phase 6 will follow on 1 September 2022 and the relevant AANA threshold for the final phase is EUR 8bn. On 21 December 2020 the EU Commission adopted the Delegated Regulation that will incorporate these extended initial margin deadlines into EMIR. That same Delegated Regulation includes the amendments to EMIR that have been under discussion for some time including the treatment of physically settled FX forward contracts and equity option contracts. These changes entered into force on 18 February 2021.

On 31 March 2021 ESMA published a revised version of its EMIR Q&A paper which is available here. Updates to the Q&A in December 2020 also clarified the status of derivatives executed on UK markets following the end of the Brexit transition period, when the UK became a "third country."

The UK 'on-shored' EMIR by way of a series of statutory instruments and binding technical standards, meaning that the UK now has its own version of EMIR (the **UK EMIR**). (See Section 5.7 below). Ahead of the on-shoring ESMA issued a Public Statement on issues affecting EMIR and SFTR reporting, which can be found here.

### 4.6 MiFID II "quick fix" amendments

"Quick fix" updates to MiFID II and changes to the research unbundling requirements came into force on 27 February 2021, as part of the EU's ongoing review of the regime and a capital markets recovery package for the COVID-19 pandemic. EU member states must transpose the changes into national law by 28 November 2021 and apply them by 28 February 2022.

The changes include:

- simplifying certain information requirements, including phasing out paper based default methods of communication, introducing an exemption from the costs and charges information for eligible counterparties and professional clients for services other than investment advice or portfolio management, and suspending best execution reports

- amending the scope of position limits in commodities markets so that they only apply to agricultural commodity derivatives and significant or critical commodity derivatives. On 19 March 2021 ESMA issued a further statement confirming that although the position limit changes start applying in 2022, the upcoming changes should be taken into account before then. ESMA therefore expects national competent authorities *not* to prioritise supervisory action against entities holding positions that will be out of scope once the changes apply.
- a new narrow hedging exemption for financial entities from the position limits regime
- 10% portfolio loss reports will no longer be mandatory for professional clients
- an optional exemption from the current research unbundling requirement if execution services and the provision of research relate to small and mid-cap issuers or fixed income instruments.

Under the "quick fix" Directive, the EU Commission is also required to carry out a further public consultation and review of various parts of the MiFID regime and report by 31 July 2021, in addition to its ongoing review of MiFID II. Legislative proposals for further changes are expected in late 2021.

The changes to MiFID II proposed under the "quick fix" Directive will not apply in the UK unless the UK makes these amendments to UK MiFID. (See Section 5.5 below for details on UK MiFID.)

### 4.7 CRR amendments relating to securitisation

In April 2021 Regulation (EU) 2021/558 was published in the Official Journal implementing amendments to the Capital Requirements Regulation (**CRR**) to adjust the securitisation framework. This may impact investment managers and their funds indirectly. The amendments aim to make securitisation more viable for institutions by:

- extending the existing EU framework for simple, transparent and standardised (**STS**) securitisations to cover on-balance-sheet synthetic securitisations and, to encourage the use of STS securitisations, preferential risk weights will be introduced for senior tranches retained by the originator
- removing the current regulatory constraints to the securitisation of non-performing exposures
- setting out a dedicated prudential treatment of synthetic excess spread (**SES**) to prevent SES being used for regulatory arbitrage purposes.

The regulation applies from 9 April 2021, except for provisions relating to SES, which apply from 10 April 2022.

### 4.8 IFR and IFD

From 26 June 2021 the Investment Firm Regulation will apply, and EU Member States are expected to apply legislation and regulation implementing the Investment Firms Directive from that date.

Currently, investment firms that are authorised under the MiFID II Directive are subject to prudential requirements set out in the CRR and the CRD IV Directive. The Investment Firms Regulation ((EU 2019/2033) (**IFR**) and the Investment Firms Directive ((EU) 2019/2034) (**IFD**) establish a new prudential framework for these firms:

- Certain systemically important firms will be reclassified as credit institutions and will be subject to prudential requirements set out in the Capital Requirements Regulation (**CRR**) and the Capital Requirements Directive

IV (**CRD IV**). These firms will not be subject to the new prudential framework that will apply to other investment firms under the IFR and the IFD. If these firms are established in member states participating in the banking union, they will come within the scope of the single supervisory mechanism.

- All other investment firms will be subject to a new prudential framework, replacing the requirements set out in the CRR and the CRD IV. Small and non-interconnected investment firms will be subject to limited prudential requirements.
- "K-factors" will be used in the classification of investment firms and in the new capital requirements methodology for investment firms. K-factors are quantitative indicators intended to represent the risks that an investment firm can pose to customers, to market access or liquidity, and to the firm itself.
- Investment firms will be subject to revised remuneration and governance standards, set out in the IFD.

The aim of the IFR is to establish an effective and proportionate prudential framework to ensure that investment firms which are authorised to operate within the EU operate on a sound financial basis and ensure harmonised prudential supervision of investment firms across the EU. The new framework forms part of the EU Commission's work to establish the Capital Markets Union.

The UK intends to introduce a revised prudential regime for FCA-authorised investment firms, the Investment Firms Prudential Regime (**IFPR**), on 1 January 2022 (see Section 5.4 below).

### 4.9 EU Short selling position reporting

ESMA's intervention, which temporarily lowered the threshold for regulatory reporting of a net short position in shares traded on an EU regulated market to 0.1% from 0.2% during the COVID-19 pandemic expired on 19 March 2021 and was not extended.

Following the end of the Brexit transition period, the UK has introduced its own regime for short selling position reporting (see Section 5.6 below for details).

### 4.10 European Commission review of AML regime

The EU Commission is due to issue its plans, including legislative proposals, in H1 of 2021 for the further harmonisation of European AML and CTF laws. The proposals are expected to include a new EU AML and CTF single rulebook, a new EU-level AML and CTF supervisor and a new coordination and support mechanism for financial intelligence units.

### 4.11 EU Benchmarks Regulation

- On 24 March 2021, ESMA published an updated statement13 (dated 9 March 2021) on the application of key provisions in the Benchmarks Regulation (**EU BMR**) in the light of Brexit.
- The update specifies the EU's regulatory approach towards UK-based third-country benchmarks as well as UK-endorsed and recognised benchmarks.

[13] The statement can be viewed here.

- Following the end of the Brexit transition period, UK-based administrators that were initially included in the ESMA register of administrators were deleted as the EU BMR no longer applies to UK based benchmark administrators; rather they qualify as third-country administrators.

- The EU BMR provides for a transitional period, as defined in Article 51(5)4 of the EU BMR, and this has been extended to 31 December 2023. The change in the ESMA register does not yet have an effect on the ability of EU27 supervised entities to use the benchmarks provided by any third country administrators, including UK ones. During the BMR transitional period (i.e. until 31 December 2023), third country benchmarks, including UK based benchmarks, can still be used by supervised entities in the EU if the benchmark is already used as a reference for financial instruments, financial contracts, or for measuring the performance of an investment fund.

- In the absence of the EU Commission granting an equivalence decision, UK-based benchmark administrators have until the 31 December 2023 to apply for recognition or endorsement in the EU. Recognising or endorsing a benchmark provided by UK-based administrator would see that benchmark included in the ESMA register again.

- The extended 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.

- Shortly following the ESMA 24 March statement, ESMA issued a new EU BMR Q&A which modified the question relating to transitional provisions applicable to third country benchmarks to reflect the extension above. The updated ESMA EU BMR Q&A can be found here.

### 4.12 SFTR

The new reporting requirements under the Securities Financing and Transaction Regulation (**SFTR**) 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. On 11 January 2021, the SFTR reporting obligation commenced for non-financial counterparties.

ESMA have recently published certain materials in relation to SFTR, issuing updated Guidelines on Reporting under Articles 4 and 12 of SFTR, see here and a new ESMA SFTR Q&A, which can be found here.

Further ongoing work on SFTR during 2021 includes ESMA's publication in Q2 2021 of guidelines on the calculation of positions by trade repositories and the development by ESMA of guidelines, Q&As and opinions on SFTR data requirements. On 23 March 2021 ESMA published its final report and guidelines on reporting of periodic information and material changes by trade repositories, which will apply from 30 June 2021. These guidelines apply to trade repositories which are registered under EMIR and SFTR but not to third country trade repositories recognised under EMIR or SFTR. Please see our updates on SFTR available here and here.

Ahead of the on-shoring ESMA issued a Public Statement with respect to the issues affecting EMIR and SFTR reporting, which can be found here.

SFTR was also on-shored by the UK under the European Union (Withdrawal) Act 2018, so similarly to EMIR, the UK now has its own version of SFTR, so called UK SFTR. (See Section 5.8 below).

### 4.13 EU PRIIPs Regulation

The PRIIPs Regulation entered into force on 29 December 2014 and its requirements became applicable in EU member states on 1 January 2018. The PRIIPs Regulation was originally intended to apply from 31 December

2016 but, in December 2016, the EU Parliament and Council decided to delay implementation, largely due to the Parliament's rejection, in September 2016, of the EU Commission's regulatory technical standards (RTS) on the presentation, content, review and revision of the key information document (KID). The KID is the key concept introduced by the PRIIPs Regulation and is a pre-contractual disclosure document, prepared for retail consumers when they are considering buying a wide range of investment products that are referred to as PRIIPs.

The PRIIPs Regulation also provides that UCITS ManCo and investment companies, and those advising on or selling units of UCITS, are exempt from the obligations under the PRIIPs Regulation originally until 31 December 2019, but later extended to 31 December 2021 (meaning that these entities only needed to produce the UCITS KIID).

The PRIIPs Regulation stipulates that the EU Commission must review it by 31 December 2019 (delayed by a year like the original implementation). However, at the time of writing, the review has not been completed. In a letter to EIOPA in February 2021,[14] it appears that the EU Commission's current plan is to review the PRIIPs Regulation as part of a wider holistic assessment of the different rules in terms of disclosure and distribution to retail investors as part of the Capital Markets Union action plan (see Section 4.3), which the EU Commission aims to complete by Q1 2022.

Amongst other things, the review will look at (i) how to achieve better alignment between PRIIPs, the insurance distribution directive (IDD) and MiFID II regarding provisions on costs disclosure; (ii) the scope of products as foreseen by the PRIIPs Regulation; and (iii) how to ensure that the KID contains the key information necessary for retail investors while avoiding too much or too complex information for these investors.

**PRIIPs KID Delegated Regulation**

The ESAs published a consultation paper[15] in October 2019 proposing a set of substantive amendments to the PRIIPs KID Delegated Regulation, including looking at:

How past performance information could be included in the KID alongside future performance scenarios.

- Different options for changing the methodologies to calculate costs and how these are presented in summary tables in the KID.
- Possible changes in view of the expiry of the exemption for UCITS and the possible use of the KID by UCITS from 1 January 2022.

Responses to the consultation highlighted industry concerns about the ESAs' proposals. Notwithstanding the concerns, in June 2020 a draft final report was submitted to the ESAs' three Boards of Supervisors for their approval. The EIOPA Board was not unanimous in its approval and consequently the ESAs were not able to formally submit the RTS to the EU Commission. The ESAs did publish a draft report which included the draft RTS.[16]

In February 2021, the ESAs all published identical press releases[17] confirming that the EIOPA Board of Supervisors had adopted the RTS by a qualified majority and submitted them to the EU Commission for

[14] The letter from the EU Commission to EIOPA is available here.

[15] The Consultation Paper (JC 2019 63) is available here.

[16] The final draft report is available here.

[17] The EBA press release is available here.

endorsement. The version that the EIOPA Board adopted remains unchanged from the version they rejected in June 2020.

With regards to the issue of the co-existence of the UCITS KIID and PRIIPs KID, the ESAs recommend in their final report that steps are taken to avoid the coexistence of the PRIIPs KID and the UCITS KIID. This is expected to mean that the UCITS Directive would need to be amended so that UCITS managers no longer have to provide a UCITS KIID to retail investors. It remains to be seen how co-existence from 31 December 2021 will be dealt with.

The EU Commission now needs to adopt the draft RTS, which is by no means guaranteed. Once adopted, they will be subject to the usual scrutiny by the Council and the European Parliament. The RTS are due to apply from 1 January 2022.

## 5. UK REGULATORY INITIATIVES

### 5.1 Financial Services Act

The UK's departure from the EU at the end of the transition period has significant implications for the regulation of financial institutions. In June 2020, the government issued a policy statement providing information on proposals for a Financial Services Bill (**FS Bill**) that would make amendments to the legislative and regulatory framework for financial services arising from the UK's departure from the EU. The FS Bill was introduced in Parliament on 21 October 2020. The FS Bill went through various stages of the UK legislative process and received Royal Assent on 29 April 2021, coming into force as the Financial Services Act 2021 (**FS Act**)[18] on the same date.

The FS Act will:

- establish the legislative framework for the Investment Firms Prudential Regime (**IFPR**) and for the UK implementation of the final Basel III standards. (See Section 5.4 for more details)
- establish the legislative framework for the Overseas Funds Regime (**OFR**) and make amendments to the retained EU law version of the Markets in Financial Instruments Regulation (600/2014) (**UK MiFIR**) relating to the equivalence regime for third country investment firms. (See Section 5.2 below for more details)
- amend the retained EU law version of the Benchmarks Regulation ((EU) 2016/1011) (**UK BMR**) to provide the FCA with additional powers to manage an orderly wind-down of a critical benchmark, such as LIBOR. (See Section 2 LIBOR for more details), and
- amend the retained EU law version of the Market Abuse Regulation (596/2014) (**UK MAR**) and increase the maximum sentence for criminal market abuse.

Section 49 of the FS Act sets out details of the commencement of individual provisions. Some entered into force on 29 April 2021, some will enter in to force on 29 June 2021 (that is, two months after Royal Assent), and others enter into force on such date as HM Treasury (or the appropriate Secretary of State) may specify in regulations. The commencement date for provisions relating to IFPR, OFR and UK BMR has not yet been announced. Some provisions relating to UK MAR will enter into force on 29 June 2021, but the commencement date for other provisions has not yet been announced.

[18] The text of the FS Act is available here.

### 5.2 Proposals for an 'overseas funds regime'

Connected to the end of the transition period, HM Treasury consulted on proposals to simplify the process for allowing investment funds set up overseas to be marketed in the UK (**OFR**). The consultation set out the government's proposal for a new process for allowing investment funds domiciled overseas to be sold to UK investors, to replace the existing regime. The consultation closed in May 2020 and the government then brought forward legislation as part of the FS Act, (see Section 5.1 above). In November 2020 HM Treasury published a summary of responses to its consultation, together with its policy decisions taken in response.

These provisions relating to the OFR are now law following the enactment of the FS Act, but the commencement date has not yet been confirmed. Please refer to the January edition of the Horizon Scanner for full details of the OFR (available by clicking here).

### 5.3 UK government to undertake a review of the UK funds regime

In the spring 2020 Budget, the government announced that it will undertake a review of the UK funds regime to ensure its continued competitiveness and sustainability. The first stages are a review of the VAT treatment of fund management fees and a consultation on the tax treatment of asset holding companies in fund structures to make the UK a more attractive location for such companies.

The consultation focussed on whether there are tax changes that could help make the UK a more attractive location for companies used by alternative funds to hold assets. It closed in August 2020 and the government issued a response paper and announced a second stage consultation in December 2020. The government believes that there is a strong case for change and the introduction of a new tax favourable regime for UK asset holding companies and launched a second stage consultation and a series of targeted 'town hall' meetings to discuss the details of what that regime should look like. The second stage consultation ran until 23 February 2021 with a view to legislation being introduced in the Finance Bill 2021.

On 26 January 2021, HM Treasury published a 'Call for Input' which sets out the objectives, scope and next steps for its review of the UK funds regime.

The Call for Input covers (i) the UK's approach to funds taxation; (ii) the UK's approach to funds regulation; and (iii) opportunities for wider reform.

With regard to (ii), the approach to fund's regulation, the Call for Input looks at matters such as:

- Fund authorisation and the driving factors behind why firms creating fund products choose authorised or unauthorised fund structures.
- Speed to market with focus on improving the timescale of the current authorisation process and providing clarity on timelines.
- Limitations of the Qualified Investor Scheme (**QIS**), details of impediments that prevent certain products from being launched as QIS and potential reform of permitted investments, borrowing cap and QIS sub-fund structure; and
- Operational efficiency and the 'Direct2Fund' investor dealing model.

With regard to (iii), opportunities for wider reform, the Call for Input is seeking feedback on matters such as:

- Whether the reforms to enhance the attractiveness of the UK funds regime should focus on appealing to AIFs targeting international markets.
- Spreading the benefits of fund administration across the UK.

- Enhancing existing fund structures and proposals for new fund structures to fill gaps identified in the range of UK fund vehicles, for example establishing a Long-Term Asset Fund (**LTAF**) and new, flexible, tax-efficient unauthorised fund structures which would be used for products aimed only at professional investors.

This Call for Input does not cover:

a) changes to the tax framework for Asset Holding Companies, which are being taken forward in a separate consultation.

b) changes to the 'on-shored' legislation associated with the UCITS Directive and AIFMD.

c) measures relating to the development of sustainable and responsible investment in the UK, which are being taken forward separately.

The deadline for providing responses to the Call for Input was 20 April 2021. The government has said it will analyse responses and then consult on specific proposals for reform. It will prioritise measures which have greater impact and those that can be delivered quickly.

### 5.4 FCA to consult on UK prudential regime for investment firms (IFPR)

The IFPR is a revised prudential regime for FCA-authorised investment firms that the government intends to establish by summer 2021. It will be based on – but not identical to – the Investment Firms Regulation (**IFR**) and the Investment Firms Directive (**IFD**) which establish a new prudential framework for EU investment firms (see Section 4.8 above).

HM Treasury and the FCA will adapt IFR and IFD to reflect the UK investment firms sector. The IFPR will apply to MiFID investment firms authorised by the FCA and will largely replace the existing prudential requirements for those firms. Its introduction will necessitate the amendment or deletion of existing legislation and regulation relating to these requirements. The IFPR will not apply to PRA-designated investment firms nor will it apply to investment firms authorised by the FCA that are not FCA MiFID investment firms

In its June 2020 policy statement on prudential standards in the FS Bill, HM Treasury stated that it intends to consult publicly on the IFPR "in due course" with a view to introducing the new regime by summer 2021.

The FCA published a discussion paper (**DP 20/2**) in June 2020 and in December 2020, published its first consultation paper on the implementation of the IFPR (**CP20/24**). In CP20/24, the FCA set out its proposals for aspects of the IFPR, including details of where it intends to diverge from the rules set out in IFR and IFD. CP20/4 looks at, among other things:

- The categorisation of investment firms.
- Prudential consolidation.
- Own funds and own funds requirements.
- Reporting requirements.

The deadline for responses to CP20/24 was 5 February 2021.

On 19 April 2021 the FCA published the second consultation paper on IFPR[19] (CP21/7) which covers items such as:

- proposals concerning own funds requirements, which supplement the proposals set out in CP20/24.

[19] CP 21/7 is available here.

- proposals for the basic liquid asset requirement
- proposals relating to risk management and governance which will introduce an internal capital and risk assessment (ICARA) process for all FCA investment firms and introduce new requirements for internal governance and controls, with certain FCA investment firms required to establish risk, remuneration and nomination committees.
- proposals to introduce a new Remuneration Code that will apply to all FCA investment firms,
- proposals concerning regulatory reporting, supplementing those considered in CP20/24, and which relate to reporting on, among other things, the liquid asset requirement and remuneration.

The deadline for responses to CP21/7 is 28 May 2021.

A third consultation paper will be published at the start of Q3 2021. The FCA intends to publish a policy statement and near-final rules in respect of each of these consultation papers and that, by the time it publishes its second policy statement in summer 2021, stakeholders will have seen near-final rules setting out the key points of the IFPR. The FCA will publish final rules once all the consultations are complete.

### 5.5 UK MiFID

The UK Markets in Financial Instruments Directive (**MiFID**) is the collection of laws and rules that regulates the buying, selling and organised trading of financial instruments. It derives from EU legislation which first took effect in November 2007 and was significantly amended in January 2018 (**MiFID II**). The UK laws and regulations implementing MiFID II were modified to address deficiencies as part of the process of onshoring EU law following the UK's departure from the EU, the on-shored version being referred as UK MiFID.

On 28 April 2021, the FCA published a consultation paper (CP21/9) setting out proposals to change the conduct and organisational requirements laid down in UK MiFID.

- SMEs and fixed income, currencies and commodities (FICC) research

The FCA proposes to amend the inducements rules relating to research to broaden the list of minor non-monetary benefits to include research on SMEs with a market cap below £200m and FICC research. It also suggests changes to the way the inducement rules apply to openly available research and research provided by independent research providers.

- Best Execution Reports

MiFID II introduced reporting requirements for execution venues (RTS 27) and for firms executing and transmitting client orders (RTS 28). The aim was to improve investor protection and transparency of the order execution process. The FCA's view is that RTS 27 and RTS 28 have not delivered on their objectives in a meaningful or effective way and are not used by market participants. The FCA is proposing to remove these two sets of reporting obligations on firms. The FCA's proposed changes cover two areas which were included in the MiFID 'quick fix' package (see Section 4.6), but it is not proposing that the UK on-shores the EU's MiFID 'quick fix' package as such. The FCA is looking for responses to CP 21/9 by 23 June 2021 and will then consider the feedback it receives. If the FCA chooses to proceed, it would publish any rules or guidance in a Policy Statement in the second half of 2021.

For more information on CP 21/9, please see our OnPoint "Brexit simplifies? - FCA consultation on changes to UK MiFID's conduct and organisational requirements", available here.

### 5.6 UK Short Selling Regulation

Similar to many other pieces of EU legislation, 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**).

In January 2021, HM Treasury laid an SI to amend the notification threshold under Article 5(2) of the UK SSR from 0.2% to 0.1% of the issued share capital of an issuer. This change came into force on 1 February 2021. Consequently, from 1 February 2021 the notification threshold for issued share capital of a company that has shares admitted to trading on a UK trading venue (UK Regulated Market and UK MTF) will be 0.1%. This is just one example of divergence between the EU and the UK following the end of the transition period, as the EU Short Selling Regulation has a notification threshold of 0.2%.

### 5.7 UK EMIR

The UK also 'on-shored' EMIR by way of a series of statutory instruments and binding technical standards, meaning that the UK now has its own version of EMIR (UK EMIR). The related FCA page, which can be found here, summarises key aspects of UK EMIR. The FCA also has a webpage dedicated to news relating to UK EMIR and EU EMIR which can be found here.

The FS Act includes provisions that will see changes to UK EMIR. These changes include amendments to Articles 4 (clearing obligation) and Article 78 (requirements for trade repositories). The FS Act inserts (i) amendments into Article 4 of UK EMIR requiring providers of clearing services to provide their services under fair, reasonable, non-discriminatory and transparent (FRANDT) commercial terms and (ii) additional provisions in Article 78 of UK EMIR to include a requirement for trade repositories to establish procedures and policies to enhance data quality on OTC transactions. Focus to date has been on the UK EMIR reporting obligation. The latest on the FCA position on reporting pursuant to UK EMIR can be found here.

Another development was announced in March 2021, when the FCA confirmed that amending a reference rate or adding a fallback would not trigger the application of margin or clearing requirements under UK EMIR, where this amendment relates to the treatment of legacy LIBOR trades. However, for UK EMIR reporting, it is essential that the UK EMIR trade data accurately reflects the details of the trade. Under Article 9 of UK EMIR, counterparties and CCPs must report any modification of a derivative contract they have concluded to a registered or recognised trade repository no later than the working day following the modification of the contract. If the terms of a derivative contract say that, either immediately or at some other point in time, an alternative rate applies in the place of LIBOR, this would bring about a modification that is reportable under UK EMIR. The FCA confirmed that they would expect this modification to be reported at the time that the alternative rate takes effect. March 2021 also saw the joint publication by the FCA and PRA of a Consultation Paper relating to the margin requirements for non-centrally cleared derivatives which relate to the FCA and PRA proposals to establish or extend exemptions for certain in-scope instruments and to align UK EMIR implementation to international standards. Responses are requested by 19 May 2021.

For entities that are subject to UK EMIR, the first clearing threshold notification by all UK FCs and NFCs must be made by 17 June 2021 regardless of whether the FC or NFC in question chooses to calculate its positions.

### 5.8 UK SFTR

SFTR was also on-shored under the European Union (Withdrawal) Act 2018, so the UK now has its own UK version of SFTR. A dedicated FCA webpage for UK SFTR can be found here, which includes a note the FCA published in November 2020 dedicated to the application of UK SFTR reporting.

In March 2021, consistent with its approach on UK EMIR, the FCA provided an update on its approach to reporting references to LIBOR in securities financing transactions under UK SFTR. Under Article 4 of UK SFTR, counterparties to securities financing transactions (**SFTs**) must report any modification of an SFT they have concluded to a registered or recognised trade repository no later than the working day following the modification of the transaction. If the terms of an SFT say that, either immediately or at some other point in time, an alternative rate applies in place of LIBOR, this is a modification which the FCA would expect to be reported at the time that the alternative rate takes effect.

On 6 April 2021, the FCA provided an update on its position on reporting Legal Entity Identifiers (LEIs) of non-EEA third country issuers under UK SFTR. Under Article 4 UK SFTR, reporting counterparties must use LEIs to identify entities when submitting transaction reports under UK SFTR. In January 2020, ESMA granted 12 months forbearance from the entry into force of SFTR reporting requirements for the reporting of LEIs of non-EEA third country issuers. Recognising that there are still many non-EEA third country issuers without an LEI, the FCA announced that they would extend the period during which reports without the LEI of a non-EEA third country issuer will be accepted until at least 13 April 2022. The FCA do however expect reporting counterparties to continue engaging with non-EEA third country issuers to acquire a LEI.

### 5.9 UK PRIIPS

The EU PRIIPs Regulation has applied across the EU since 1 January 2018. Like other EU legislation that is directly applicable within the EU, it became part of UK law at the end of the transition period. This means that there are now two versions of the legislation operating in parallel: the original EU PRIIPs Regulation and the UK PRIIPs Regulation which incorporates amendments made during the on-shoring process.

Both the EU and UK PRIIPS Regulation set the requirements for a standardised disclosure document, known as the Key Information Document (**KID**) that must be provided to retail investors when they purchase particular packaged investment products, known as 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 retail investors in the UK. Instead, they are expected to prepare or provide key investor information documents (KIIDs) under the disclosure regime in the UCITS Directive. The exemption is due to expire on 31 December 2021 but, as discussed below, the FS Act, which became law on 29 April 2021, proposes that the exemption be extended for up to five years (i.e. until 31 December 2026).

In June 2020, the government announced plans to introduce legislation to improve the functioning of the PRIIPs regime in the UK. It followed this up in July 2020 with a policy statement (available here) that contained information on three proposed amendments to the UK framework. These amendments were included in the FS Act and are as follows:

- Clarification of the scope of the UK PRIIPs Regulation – there is currently significant uncertainty in industry as to the precise scope of PRIIPs. The FS Act provides that the FCA may make rules specifying whether or not a product, or category of product, falls within the definition of a PRIIP, enabling the FCA to address existing, and potentially future, ambiguities relating to certain types of investment product. The definition of a PRIIP would remain unchanged.

- Replacement of “performance scenario” with “appropriate information on performance” in UK PRIIPs Regulation. The current methodology for calculating these scenarios has been criticised for producing misleading performance scenarios across a wide range of products. The FS Act amends the UK PRIIPS Regulation so that “performance scenarios and the assumptions made to produce them” is replaced by "information on performance," which enables the FCA to amend the UK PRIIPs KID Delegated Regulation to clarify what information on performance should be provided in the KID.

- Further extension of the current UCITS exemption. UCITS funds are exempted from the requirements of the PRIIPs Regulation until 31 December 2021. Until that date, instead of a KID, UCITS funds must produce a Key Investor Information Document (**KIID**) per the requirements of the UCITS Directive. The FS Act delegates power to HM Treasury to further extend the exemption for UCITS for up to five years.

The government also announced that, in the longer term, it intends to conduct a more wholesale review of the disclosure regime for UK retail investors. The wider review will explore, for example, how to harmonise the PRIIPs regime with requirements in MiFID II.

### 5.10 UK Benchmarks Regulation

The FS Act (see section 5.1) makes amendments to the UK Benchmarks Regulation and the FCA has published a document entitled "Benchmarks Regulation and proposed amendments under the Financial Services Bill."[20] The document summarises the UK BMR and the transition from LIBOR, as well as giving an overview of the proposed amendments to the UK BMR to be made by the FS Act. (See also Section 2 – LIBOR).

In March 2021, following a consultation, the FCA published a statement of policy on the designation of unrepresentative benchmarks under new Article 23A of the UK BMR, setting out the factors the FCA will take into consideration when deciding whether it should designate a critical benchmark as an Article 23A benchmark. A second statement of policy was also published setting out the FCA's approach to the exercise of its new powers under Article 23D to impose certain requirements on the administrator of a critical benchmark designated under Article 23A. Further consultations are expected during Q2 2021 with respect to other aspects of the UK BMR as amended by the FS Act.

### 5.11 HM Treasury proposals to amend the financial promotions approval regime

In July 2020, HM Treasury announced a consultation on limiting the scope of firms that can approve the financial promotions of unauthorised persons. The term "financial promotion" describes the communication of an invitation or inducement to engage in investment activity. Section 21 of the Financial Services and Markets Act 2000 (or **FSMA**) provides that a firm must not, in the course of business, communicate a financial promotion unless the firm is FCA-authorised or the content of the communication is approved by an authorised firm (subject to certain exemptions).

The consultation closed on 25 October 2020. The government stated that it will analyses the responses and, in due course, set out the next steps including which policy options it intends to take forward.

There have been no developments since 29 January 2021. Please refer to the January edition of the Horizon Scanner for full details (available by clicking here).

### 5.12 HM Treasury proposes expansion of financial promotion regime to include cryptoassets

HM Treasury launched a second consultation in July 2020 setting out proposals to expand the perimeter of the financial promotion regime to bring the promotion of certain types of unregulated cryptoassets within its scope. This consultation and the consultation on the approval of financial promotions of unauthorised firms (see 5.9 above) should be read together.

[20] The document is available here.

The deadline for responses was 25 October 2020. The government has stated that it does not propose to introduce a transitional period before the proposed Financial Promotion Order amendments come into force.

There have been no developments since 29 January 2021. Please refer to the January edition of the Horizon Scanner for full details (available by clicking here).

### 5.13 UK Fintech Strategic Review

In July 2020 the government announced a strategic review (click here) into the UK's financial technology industry which aims to establish priority areas for industry, policy makers, and regulators to explore in order to support the ongoing success of the UK fintech sector and to identify opportunities to support further growth in the sector.

On 26 February 2021, the government published its report, the Kalifa Review on UK FinTech (the **Kalifa Review**), which makes recommendations for the creation and implementation of a new UK FinTech policy and regulatory strategy (available here).

Ultimately, the review seeks to advance three objectives, "*Ensuring UK fintech has the resources to grow and succeed, creating the conditions for continued widespread adoption of fintech solutions to benefit businesses and individuals and maintaining and advancing UK fintech's global reputation for the innovation and transformation of financial services*."

The Kalifa Review identified a Five-Point Plan of recommendations covering:

1) Policy and Regulation – including delivery of a digital finance package that creates a new regulatory framework for emerging technology, and implementing a "Scalebox" that supports firms focusing on scaling innovative technology.
2) Skills – ensuring fintech has a sufficient supply of domestic and international talent and the means to train and upskill our current and future workforce.
3) Investment – including improving the listing environment through free float reduction, dual class shares and relaxation of pre-emption rights, and creating a global family of fintech indices to enhance sector visibility.
4) International – including a targeted approach to exports and inward investment and delivering an international action plan for fintech.
5) National connectivity – including driving national coordination strategy through Centre for Finance, Innovation and Technology and accelerating the development and growth of fintech clusters through further investment, such as in R&D.

The review highlights three main challenges to the UK's leading fintech position –international competition, the regulatory uncertainty caused by Brexit and the consequences of the COVID-19 pandemic.

On 19 April 2021 HM Treasury issued a press release on proposals to "*enhance the UK's competitive advantage in fintech, from regulatory support* and *reforms to help firms grow to a new taskforce to lead the UK's work on a central bank digital currency*." The Chancellor confirmed the UK will be taking forward many of the recommendations made in the Kalifa Review, including the development by the FCA of the 'scale box' – mentioned at 1) above and described as a package of measures to enhance the FCA's regulatory sandbox, which has allowed start-ups to test new propositions.

The Kalifa Review and recommendations are relevant across multiple industries as well as the fintech sector. The government will set out a detailed response to the Kalifa Review shortly.

### 5.14 FCA regulation of cryptoassets

Regulation of cryptoassets remains on the agenda. On 7 January 2021 HM Treasury launched a consultation on the broader regulatory approach to cryptoassets, including new challenges from stablecoins, with a deadline for comments of 21 March 2021.

The annex to the consultation includes a timeline of recent and ongoing workstreams, including potential HM Treasury legislation later in 2021.

There have been no significant developments since 29 January 2021. Please refer to the January edition of the Horizon Scanner for full details (available by clicking here).

## 6. U.S. REGULATORY INITIATIVES

### 6.1 Substantial Overhaul of the SEC Advertising and Solicitation Rules

The SEC has finalized its amendments to Rule 206(4)-1 – Advertisements by Investment Advisers (**Old Advertising Rule**) and Rule 206(4)-3 – Cash Payments for Client Solicitations (**Old Solicitation Rule**) under the Advisers Act, as well as technical amendments to Rule 204-2 (the **Recordkeeping Rule**) and Form ADV, Part 1A (separately, **Updated Advertising Rule** and **Updated Solicitation Rule**, and collectively, **New Rules**). The New Rules were adopted on 22 December 2020 and all advertisements by advisers that are registered or required to be registered with the SEC are required to be in compliance by 4 November 2022.

These changes, while mainly of concern to SEC-registered investment advisers, will also be relevant to managers that are not registered with the SEC, as the Advertising Rules are generally considered largely applicable to all advisers via the "Anti-Fraud" provisions of the Advisers Act.

The Updated Advertising Rule dramatically revises and modernizes the regulatory framework for investment adviser and private fund marketing materials. It replaces the current set of rigid prohibitions (particularly those relating to testimonials and past specific recommendations) with a more flexible, principles-based approach, and codifies and rationalizes the patchwork of guidance provided through SEC enforcement actions and Staff no-action letters (particularly as these apply to performance advertising) over prior years. Among other things, the Updated Advertising Rule:

a) Brings the regulatory scheme into the 21st century and adapts it from primarily paper-based premises to a more technology-neutral basis that recognizes the realities of the Internet, social media and mobile applications;

b) Eliminates unnecessary or outdated requirements; and

c) Relies more expressly on compliance policies and procedures, as well as additional reviews by advisers, than under the Old Advertising Rule.

While the changes in the Updated Solicitation Rule are less fundamental, they also reflect a significant modernization of the Old Solicitation Rule (which is now subsumed in the New Advertising Rule) with a more streamlined structure.

Certain deviations from the proposal issued in 2019 include:

a) the proposals regarding distinguishing between retail and non-retail investors was not adopted;

b) the definition of advertisement was not expanded to one-on-one communications;

c) internal review and written approval of advertisements by certain adviser personnel is not required prior to dissemination; and

d) the requirements surrounding advertisements that display predecessor performance are less onerous than was proposed.

Further detailed publications on the New Rules will be forthcoming from Dechert LLP.

### 6.2 New York Updates Local Filing Rules Ending Lack of Clarity for Rule 506 Offerings

#### *Background*

The offering of securities in New York is subject to state regulation under local law known as the Martin Act. The Martin Act generally regulates securities dealers rather than offerings and sales of securities themselves; however, the definition of “dealer” includes the issuer of a security, meaning that funds could be considered to be dealers. Because of this definition, the Martin Act technically required the registration of a fund as a dealer using a Form 99 and additional filings.

This approach has been viewed by many as inconsistent with requirements of federal securities laws, including Rule 506 of Regulation D under the Securities Act of 1933 (Rule 506). As a result, many lawyers and advisers have taken the position that the New York Martin Act requirements have been pre-empted by U.S. federal law (the National Securities Markets Improvement Act of 1996). As such, many funds and other similar issuers conducting Rule 506 offerings did not file with the New York state authorities under the Martin Act citing the pre-emption principal, which was supported in a published position by the New York Bar Association’s Committee on Securities Regulation (August 2002).

#### *Amendment*

On 2 December 2020, new rules came into effect in New York which require, consistent with most other U.S. states, that issuers making private placements offerings in compliance with Rule 506 must file a copy of the issuer’s federal Form D with the relevant authorities in New York within 15 days of the first sale within or from the state of New York.

#### *Impact*

While the changes are a welcome clarification for practitioners and issuers alike, issuers that have made sales in New York and have an ongoing offer should consider making a Form D filing in the state of New York at this time. Form D requires submission of “the initial date of offering” in the United States and “the total amount sold” in the United States as well as disclosure on brokers used (if any) as well as any sales commissions paid. While closed-end private funds will likely be able to determine this relatively easily, older funds which have a continuing offer may have difficulty providing this information.

In such circumstances, advisers should speak with Dechert or their fund counsel in relation to determinations on how to proceed.

### 6.3 Proposed amendment to Rule 13f-1 and Form 13F

In July 2020, the SEC proposed amendments to Rule 13f-1 of the Securities Exchange Act of 1934 and the corresponding Form 13F which would dramatically raise the reporting threshold for institutional investment managers, from US$100 million to US$3.5 billion, to reflect the change in size and structure of the U.S. equities market since 1975, when Rule13f-1 was adopted. Rule 13f-1 and the corresponding Form 13F relate to required reporting by institutional investment managers of positions meeting the reporting thresholds of specified publicly traded equity securities. The proposed amendments would also amend Form 13F to increase the information provided by institutional investment managers by eliminating the omission threshold for individual securities, and requiring managers to provide additional identifying information. There are also additional proposed amendments to modernize the structure of data reporting and to take account of confidential treatment requests per recent U.S. Supreme Court jurisprudence.

The comment period for the proposal closed and it is notable that the New York Stock Exchange issued a commentary submission against the proposal on the basis that it would decrease transparency in the markets. Further updates will be made when available.

### 6.4 SEC Registration of UK Managers

Following the implementation of the European Union's (**EU**) General Data Protection Regulation (**GDPR**), non-U.S. firms have been unable to register with the SEC as investment advisers pursuant to the Advisers Act because of concerns held by the SEC's Staff regarding the impact of GDPR on the cross-border transfer of data.

Specifically, the Staff's fears were based on the fact that provisions of GDPR seemed to prevent the Staff from obtaining prompt, direct access to the books and records of EU firms.

A number of industry groups have been involved in lobbying the SEC on behalf of their members to resolve this issue and find ways to address the SEC's concerns. The industry groups have actively encouraged a direct dialogue between the SEC and UK Information Commissioner's Office (**ICO**), which has met with success.

The ICO has provided comfort to the SEC, in the form of a letter to the SEC staff dated 11 September 2020 and made publicly available on 19 January 2021 (click here), that UK firms can, according to the ICO's interpretation of GDPR, share any necessary data with the SEC without breaching the provisions of GDPR.

SEC Acting Chairman Elad Roisman has published a Public Statement on 19 January 2021 confirming this (click here).

The SEC's position only covers UK firms at this time, but we understand that other jurisdictions have been in discussions with the SEC and are hopeful that relief will be forthcoming.

For further information, please do not hesitate to get in touch with a member of Dechert's financial services team or your usual Dechert contact.

Dechert's financial services advisory capability spans 16 jurisdictions including Ireland, Luxembourg, Germany, France and Belgium as well as throughout the United States, Middle East and Asia. Please visit dechert.com for further detail.

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