

# What does 2023 hold?

Key upcoming developments and enforcement trends

LONDON FINANCIAL INSTITUTIONS REGULATORY AND ENFORCEMENT

# Contents

What happened in 2022?	03
What should we expect in 2023?	05
Global Enforcement Themes	07
Enforcement and Financial Crime	10
Regulatory Direction of Travel in the UK	14
Markets, Funds and Investments	18

ESG	22
Risk, Governance and Oversight	25
Tech, Innovation and Data	28
Crypto	31
Consumer Protection	34
London Financial Services Regulatory Key Contacts	37





# What happened in 2022?

In years past, at the turn of the year we have normally undertaken an assessment of our annual predictions for the year just gone in financial services regulation, checking the accuracy of our crystal ball and recalibrating for the year ahead.

However, the last three years have made this task nearly impossible. From the COVID-19 pandemic which swept across the globe in 2020 (and continues to simmer in the background), to the crisis in Ukraine, to supply chain and logistics failures and, most recently, to the cost of living crisis, anticipating regulatory priorities and predicting developments for the year ahead have become a bit of a fool's game. Over the past 36 months regulators around the world have moved at pace to contain the knock-on effects of these difficulties, modifying regulatory programmes and delaying planned reforms to institute emergency measures, and in response, in early 2022 we abandoned our predictions entirely. We did, however, issue our **UK Regulatory Top Ten Watch List for 2022**, setting out ten key developments for financial institutions and fintechs to watch in 2022.

We told firms to be prepared for more action on fair customer treatment and consumer protection, most pressingly due to the industry's need to

prepare for the forthcoming Consumer Duty, but also in relation to further potential measures on diversity and inclusion (D&I), and regarding stricter requirements for financial promotions and a new gateway for the approval of financial promotions.

We expected progress to be made in expanding the regulatory perimeter, with significant advancement bringing buy-now-pay-later (BNPL) products and cryptoassets within the scope of regulation. We foresaw supervisory efforts prioritising key areas like the appointed representatives regime, operational resilience and ESG regulation. We anticipated that financial crime would remain a top enforcement priority for the FCA. And, above all, we expected further significant work being put into developing the architecture and perimeter of the UK's financial services regulatory framework as we moved forward post-Brexit.



Were we right to highlight these as key developments? Perhaps the answer is “yes, generally, but on a longer time frame”. Of course, all of these areas remained priorities for the regulators and policymakers in 2022, but timetables seem to have universally slipped and many of these developments remain on the watchlist for 2023. Consumer Duty implementation remains on track – indeed, it is one of the FCA’s flagship new regimes for 2023 – and stricter requirements for financial promotions have started to take effect. The appointed representatives regime, operational resilience and ESG regulation remain supervisory priorities and promised reforms have been set in motion (with more on the way). Financial crime was indeed a top area of focus for enforcement action as it has remained for the last few years. But implementation of the financial promotions gateway awaits final passage of the Financial Services and Markets Bill (FSM Bill) and commencement regulations, and further measures on D&I have been delayed multiple times, with a consultation now expected at some point in 2023.

Progress expanding the regulatory perimeter was more mixed; provisions establishing a regulatory regime for stablecoins are included in the FSM Bill, but BNPL regulation has stalled with secondary legislation not yet laid (and now expected in early 2023). We were, however, absolutely correct to anticipate further significant work on the architecture and perimeter of the UK’s post-Brexit regulatory framework, with significant reform programmes being launched through both the FSM Bill over the summer and the Treasury’s Edinburgh Reforms package in December. These programmes, which are interlinked and overlapping, will firmly set the course for post-Brexit UK regulation. Once finalised, the FSM Bill will result in a sea change for financial services regulation in the UK – it overhauls the UK financial regulatory architecture, establishing a framework for the revocation of retained EU law, reforming the wholesale markets regulatory framework, implementing a regime to regulate critical third-party service providers, and bringing activities involving certain stablecoins into the UK regulatory perimeter. Building on the reform

agenda set out in the FSM Bill, the Edinburgh Reforms have the potential to be hugely wide-ranging, involving significant changes to the banking, capital markets and payments regulatory frameworks, touching on consumer and wholesale business; they include an overhaul of the UK’s regulation of prospectuses, reforms to the ring-fencing regime for banks, reforms to the PRIIPs retail investment framework, changes to the short selling regime and reform of the Consumer Credit Act, amongst others. They also include potential reforms to some of the major defining features of UK domestic regulation, like the ring-fencing regime and the Senior Managers and Certification Regime (SMCR), both of which have been globally influential and are certainly entrenched.





# What should we expect in 2023?

So where are we now? It has been two years since the end of the Brexit transition period. The dust has also somewhat settled on the post-pandemic “normality” – only for the dust to have been kicked up again, and with great force, by the conflict in Ukraine and the cost of living crisis. Although there is never a quiet moment in the financial regulatory world that we all inhabit, it feels that 2023 is poised to be a year when, even by the usual standards of the sector, an awful lot of things are going to happen.

Taking stock of the regulatory landscape, significant work has been and will continue to be done to reshape and strengthen the UK financial services regulatory framework. At a domestic level, the most significant piece of primary legislation in our space since the Financial Services and Markets Act 2000 (FSMA), the FSM Bill, is currently making its way through Parliament (at the time of writing) and promises to create wholesale and far-reaching changes to our domestic regulatory regime. Perhaps 2023 will be the first year where the UK meaningfully starts to diverge from the EU, moving away from the granular and technical approach of EU law, to a more principles-based, agile framework with obligations being set down in regulatory rules.

Together with progress on the FSM Bill, we will certainly see movement on the Edinburgh Reforms programme of measures, though the extent to which those measures will be finalised in 2023 is unclear. HM Treasury (HMT) has grouped the Edinburgh Reforms into three tranches in a phased roadmap. Work has already begun on the first tranche, which includes securitisations, Solvency II and changes arising from the Wholesale Markets Review, and the government expects to make significant progress on Tranches 1 and 2 by the end of 2023. The pace of these changes

will vary, of course – many of the announced reforms are, in reality, announcements of forthcoming reviews and consultations, which will no doubt draw out the process beyond 2023.

We also expect to see significant modernisation of financial services legislation in the UK to upgrade the framework for the current environment, reflecting the fact that the way that financial services are delivered today is very different to how it was 23 years ago when FSMA was enacted. Although the focus of many of these new initiatives has been around enhancing consumer protection, we are seeing legislation being brought forward to account for the emergence of – for example – stablecoin payments and the prospect that payment systems using Distributed Ledger Technology could become systemically important in the future. Similar trends can be observed in the EU, which is bringing forward its own measures in some of these areas. We are also starting to see the beginnings of some regulatory competition between the UK and EU, with each looking to the other for inspiration to some degree, but doing things in a sufficiently divergent way so as to ensure a frustrating degree of complexity for financial institutions.

Things are moving at such a fast pace that it is difficult for policymakers to keep up. The recent events in the crypto market, for example, have caused some to question whether the regulatory reforms already proposed in this space go far enough, and whether they sufficiently address the potential risks that are now in focus. Even when we get through the multitude of crypto reforms currently on the table – including new stablecoin regimes in the UK and EU, implementation of the Financial Action Task Force’s (FATF) travel rule, and a forthcoming expansion of the UK financial promotions perimeter to include crypto – we can expect there to be more where that came from.

Further, in the midst of these reforms and legislative changes, firms will need to implement one of the most important set of rule-changes for some time, with the advent of the FCA’s new Consumer Duty regime. Described by the FCA as a “paradigm shift” in how firms engage with retail customers, the new rules will require firms to consider the needs, characteristics and objectives of their customers – including those with characteristics of vulnerability – and how they behave, at every stage of the customer journey. As well as acting to deliver good customer outcomes, firms will need to understand and evidence whether those outcomes are being met. We also expect the regulators

to continue their work to enhance regulations from lessons learnt following the pandemic, as we transition to mitigations dealing with the cost of living crisis. There is likely to be continued review of firms to ensure that they are meeting expectations and providing support to customers in financial difficulty.

We are also seeing the regulators taking early steps to grapple with further technological advances that are in a more nascent stage, notably on the increasing use of artificial intelligence in financial services, and the advent of quantum computing, which has the potential to be revolutionary. During 2023 we’ll see the regulators taking further steps to educate themselves about the potential of these technologies, with a focus on risks as well as benefits.

Finally, we will no doubt see a continued regulatory focus on enforcement and holding firms to account for their actions. This is particularly the case in relation to financial crime – six of the largest fines imposed by the FCA since the start of 2019 have related to financial crime breaches, and the first successful criminal prosecution under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs) concluded in 2022. There were a further two enforcement actions

on anti-money laundering (AML) in early January 2023, and we can expect this trend to continue. In addition to financial crime, we expect the focus to be on individual accountability, harmful conduct in the retail sector, and – perhaps once the FCA finalises its anti-greenwashing rule in the summer – action relating to greenwashing and misleading ESG claims. One thing is clear: as Mark Steward’s tenure at the FCA draws to an end, there is a sense that more investigations run under his tenure may be reaching their conclusion before his departure.

Whatever 2023 may bring and the accuracy of our predictions, we look forward to working with you on what’s to come.





# Global Enforcement Themes

Jurisdiction	Top 3 enforcement areas	Anticipated enforcement action against financial institutions	Anticipated enforcement action against senior managers/staff in financial institution
<b>Argentina</b>	<ul style="list-style-type: none"> <li>Financial promotion/advertising</li> <li>Financial crime</li> <li>Client money/assets</li> </ul>	Increase	Increase
<b>Australia</b>	<ul style="list-style-type: none"> <li>Mis-selling</li> <li>Retail conduct</li> <li>Culture/governance</li> </ul>	Increase	Stay at broadly the same level
<b>Belgium</b>	<ul style="list-style-type: none"> <li>Mis-selling</li> <li>Culture/governance</li> <li>Financial crime</li> </ul>	Stay at broadly the same level	Stay at broadly the same level
<b>China</b>	<ul style="list-style-type: none"> <li>Retail lending</li> <li>Financial crime (mainly in the field of money laundering)</li> <li>Culture/governance</li> </ul>	Increase	Increase
<b>DIFC</b>	<ul style="list-style-type: none"> <li>Financial crime</li> <li>Culture/governance</li> <li>Financial promotions/advertising</li> </ul>	Increase	Increase
<b>France</b>	<ul style="list-style-type: none"> <li>Financial crime and market abuse</li> <li>Mis-selling</li> <li>Retail conduct and financial promotions/advertising</li> </ul>	Stay at broadly the same level	Stay at broadly the same level





# Global Enforcement Themes

Jurisdiction	Top 3 enforcement areas	Anticipated enforcement action against financial institutions	Anticipated enforcement action against senior managers/staff in financial institution
<b>Germany</b>	<ul style="list-style-type: none"> <li>Financial crime</li> <li>Culture/governance</li> <li>Retail conduct</li> </ul>	Increase	Increase
<b>Hong Kong</b>	<ul style="list-style-type: none"> <li>Financial crime</li> <li>Market conduct</li> <li>Culture/governance</li> </ul>	Stay at broadly the same level	Stay at broadly the same level
<b>Italy</b>	<ul style="list-style-type: none"> <li>Retail conduct</li> <li>Financial promotions/advertising</li> <li>Financial crime</li> </ul>	Stay at broadly the same level	Stay at broadly the same level
<b>Netherlands</b>	<ul style="list-style-type: none"> <li>Financial crime (AML)</li> <li>Mis-selling (including ESG disclosures)</li> <li>Culture/governance (especially remuneration)</li> </ul>	Stay at broadly the same level	Stay at broadly the same level
<b>Singapore</b>	<ul style="list-style-type: none"> <li>Market conduct/market abuse</li> <li>Mis-selling</li> <li>Financial crime</li> </ul>	Stay at broadly the same level	Stay at broadly the same level
<b>South Africa</b>	<ul style="list-style-type: none"> <li>Financial crime</li> <li>Client money/assets</li> <li>Market conduct/market abuse</li> </ul>	Increase	Stay at broadly the same level
<b>Spain</b>	<ul style="list-style-type: none"> <li>Market conduct/market abuse</li> <li>Retail conduct</li> <li>Culture/governance</li> </ul>	Increase *(in total value of fines but not volume of enforcement actions)	Stay at broadly the same level



# Global Enforcement Themes

Jurisdiction	Top 3 enforcement areas	Anticipated enforcement action against financial institutions	Anticipated enforcement action against senior managers/staff in financial institution
<b>Switzerland</b>	<ul style="list-style-type: none"> <li>▪ Market conduct</li> <li>▪ Governance</li> <li>▪ Financial crime</li> </ul>	Increase	Stay at broadly the same level
<b>Thailand</b>	<ul style="list-style-type: none"> <li>▪ Financial promotions/advertising</li> <li>▪ Financial crime</li> <li>▪ Client money/asset</li> </ul>	Increase	Increase
<b>Turkey</b>	<ul style="list-style-type: none"> <li>▪ Mis-selling</li> <li>▪ Retail conduct</li> <li>▪ Culture/governance</li> </ul>	Increase	Stay at broadly the same level
<b>UK</b>	<ul style="list-style-type: none"> <li>▪ Mis-selling</li> <li>▪ Culture/governance</li> <li>▪ Financial crime</li> </ul>	Increase	Increase (but not by much)
<b>USA</b>	<ul style="list-style-type: none"> <li>▪ Retail lending</li> <li>▪ Financial crime (mainly in the field of money laundering)</li> <li>▪ Culture/governance</li> </ul>	Increase (but not by much)	Stay at broadly the same level



# Enforcement and Financial Crime

Looking first at regulatory enforcement in the UK, we will no doubt see a continued focus on holding firms to account for their actions. This is particularly the case in relation to financial crime – six of the largest fines imposed by the FCA since the start of 2019 have related to financial crime breaches, and the first successful criminal prosecution under the MLRs concluded in 2022.

There were a further two enforcement actions on AML in early January 2023, and we can expect this trend to continue.

Turning to financial crime, regulation to combat various areas of financial crime is, by its nature, dynamic; seeking to combat new tactics from criminal groups, or to address arising market concerns, legislators and regulators must continue to adapt existing rules to ensure that they are fit for purpose.

A key front in the fight against financial crime has been, and continues to be, in the area of AML and counter-terrorist financing (CTF). In the context of the conflict in Ukraine and the myriad new sanctions (all of which bring potential for proceeds of crime), regulators will continue to examine the role that financial institutions play in facilitating illicit transactions. In addition, emerging technologies such as crypto have changed the way that traditional money laundering is occurring.

Last year this led to a review by HMT of the UK's AML regime, and amendments to the MLRs to address perceived shortcomings in the AML rules for crypto (in particular, by introducing a change of control regime for registered cryptoasset service providers and an equivalent of the FATF's travel rule for crypto transactions). While the change in control regime took effect in August 2022, firms have been given a longer implementation period for the travel rule for crypto, which is due to apply in September 2023. The EU's version of the travel rule for crypto is also likely to progress in 2023, with a delayed plenary vote in the European Parliament now scheduled for April 2023.





This is being supported on the enforcement side by a new crypto team established by the National Crime Agency with a focus on cyber and crypto crimes and a new Economic Crime and Corporate Transparency Bill which will make tweaks to both the Proceeds of Crime Act 2002 and other related measures to encourage information sharing amongst other things.

Outside of the changes relating to crypto, HMT's review suggested that, overall, the UK's AML regime is working effectively enough that no wholesale changes are needed; instead, HMT will take an incremental approach to improvements and remedying deficiencies using structures already in place.

Meanwhile, in the EU, the reform approach is decidedly different: progress continues to be made on a new AML directive, single rulebook and single EU anti-money laundering authority. It is expected that these legislative proposals will be adopted during the course of 2023, with implementation anticipated to start in 2024 and phased in thereafter (subject to the final form of the proposals adopted). These rules will continue the further harmonisation of EU money laundering rules and create a single supervisory body for the first time.

## In addition to financial crime, we expect enforcement action to focus to a number of themes in 2023:

### Individual accountability

Since the advent of the SMCR in 2016, the industry has assumed there would be a significant increase in enforcement action against senior managers, but the volume of expected action has yet to materialise. Interestingly, the FCA appears to be opening more SMCR investigations, but it remains to be seen whether this will translate into enforcement outcomes. Perhaps this can be traced back to Mark Steward's approach, opening a larger volume of investigations which are seen as "diagnostic" and not necessarily expected to lead to enforcement outcomes. Moreover, given what is at stake for them personally, individuals tend to challenge regulatory decisions rather than choosing to settle early. We expect the focus to remain on individual accountability, whether that is at the policy or enforcement stage.

### Retail sector enforcement

While there were relatively few enforcement decisions in the retail sector in 2022, it is clear that the FCA is prioritising this area going forward. The impact of inflation, the gilt market surge and the cost of living crisis have heightened the FCA's concerns about the treatment of vulnerable customers at a time when the number of customers exhibiting characteristics of vulnerability looks set to increase. Further, although enforcement cases under the Consumer Duty itself will take a bit of time to work their way through, the FCA has indicated that it will take inspiration from the forthcoming Duty and seek to rely on the Principles for Businesses to enforce robustly against harmful conduct in the retail space (as it has always done).

### Greenwashing

Is 2023 finally the year for greenwashing enforcement action? The FCA has sent conflicting messages over the past year or so on enforcement against greenwashing or misleading ESG claims. On the one hand, the FCA indicated in late 2021 that greenwashing enforcement action was already underway. On the other hand, the FCA stated in July 2022 that it was in no rush to "wield its big enforcement stick" and that firms should be given time to get things right. The FCA is expected to finalise a general anti-greenwashing rule by the end of the first half of 2023 – perhaps we may see the emergence of the "big enforcement stick" for greenwashing after that.

Finally, Mark Steward will leave the FCA in spring 2023, and a new head of enforcement will take over. His tenure has been marked by large volumes of investigations and huge delays to the progress of enforcement actions with outcomes that might not have lived up to expectations. One new approach from the incoming head of enforcement might be leaner investigations and quicker outcomes, rather than the delays that have characterised the last few years. It will also be interesting to see if the FCA tries to bare its teeth more through stronger outcomes (perhaps in relation to insider dealing and market misconduct) in an effort to assert its authority over the industry.



## Key trends and issues

- 1** We expect enforcement action relating to financial crime to continue apace, as regulators in the UK and around the world get to grips with global instability and emerging technologies from which new threats arise.
- 2** Firms should continue to track the EU's AML/CTF reform package of measures, which are expected to complete the legislative process in 2023.
- 3** In addition to financial crime, enforcement themes to look out for in 2023 include individual accountability, harmful conduct in the retail sector, and – perhaps once the FCA finalises its anti-greenwashing rule in the summer – action relating to greenwashing and misleading ESG claims. The end of the Mark Steward era may also mark a shift in the FCA's approach to the investigations enforcement process, perhaps with stronger outcomes to come.

# Timeline

		EU		UK		EU		International
		De-risking guidelines		FCA Director of Enforcement and Market Oversight		EU cryptoasset transfers		FATF UK MER
		The European Banking Authority's (EBA) consultation on guidelines on the effective management of money laundering and terrorist financing risks when providing access to financial services closes to comments. The guidelines aim to address the adverse impacts of de-risking and ensure access to financial services is maintained for vulnerable customers.		Mark Steward will step down as Director of Enforcement and Market Oversight in spring 2023.		The EU Parliament is expected to vote in plenary on the proposed Regulation on information accompanying transfers of funds and certain cryptoassets, which will implement the travel rule for cryptoasset transfers the EU. Provisional political agreement was reached in June 2022.		The FATF is expected to carry out its next mutual evaluation review (MER) of the UK's AML/CTF regime in 2025.
2023	2023	6 FEB 2023	20-24 FEB 2023	SPRING 2023	1 APR 2023	17 APR 2023	1 SEP 2023	2025
UK	EU	International		UK		UK		
Economic Crime and Corporate Transparency Bill 2022	EU AML regime reform	Beneficial ownership		Reporting of material discrepancies		UK cryptoasset transfers		
The Economic Crime and Corporate Transparency Bill 2022 is expected to progress through the legislative process.	The Council and EU Parliament will continue to consider the EU Commission's proposed AML reform package.	At its February 2023 meetings, the FATF is expected to consider responses to its consultations on revising its recommendation, interpretative note and guidance on transparency and beneficial ownership of legal arrangements and persons.		Provisions in the Money Laundering and Terrorist Financing (Amendment) (No 2) Regulations 2022 expanding the reporting of material discrepancies to cover ongoing business relationships come into effect.		The travel rule for cryptoasset transfers comes into force, following a 12 month transitional period to allow cryptoasset businesses to update their systems and controls.		





# Regulatory Direction of Travel in the UK

It has been two years since the end of the Brexit transition period. The dust has also somewhat settled on the post-pandemic “normality”. Taking stock of the regulatory landscape, significant work has been and will continue to be done to reshape and strengthen the UK financial services regulatory framework.

Beyond Brexit, the broader regulatory theme has shifted to UK-EU divergence and the development of post-transition UK law from retained EU frameworks.

Throughout 2022, HMT consulted on the Future Regulatory Framework Review, culminating in a policy statement on building a smarter financial services framework for the UK issued in December 2022. Last year also saw the introduction of the Financial Services and Markets Bill 2022-23 (FSM Bill), the largest piece of financial services legislation since the Financial Services and Markets Act 2000 (FSMA). Once finalised, the FSM Bill will result in an overhaul of the UK financial regulatory architecture, establishing a framework for the revocation of retained EU law, reforming the wholesale markets regulatory framework, implementing a regime that regulates critical third-party firms, and bringing activities involving certain stablecoins into the UK regulatory perimeter.

Building on the reform agenda set forth by the FSM Bill, the government announced a package of wide-ranging reviews and reforms known as the Edinburgh Reforms in December 2022 to drive growth and competitiveness in the financial services sector. These proposals involve significant changes to the banking, capital markets and payments regulatory frameworks, touching on consumer and wholesale business; they include an overhaul of the UK’s regulation of prospectuses, reforms to the ring-fencing regime for banks, reforms to the PRIIPs retail investment framework, changes to the short selling regime and reform of the Consumer Credit Act, amongst others.



Firms with existing or prospective operational footprints in Europe will be faced with a new set of regulatory and commercial challenges following increasing divergence of UK laws from parallel regulations in the EU, as retained EU law is repealed and replaced in a programme of three tranches. The first tranche of this work has already begun, covering the Wholesale Markets Review, Lord Hill's Listing Review, the Securitisation Review and the review into the Solvency II Directive, with significant progress ambitiously promised on tranches one and two by end of 2023. This regulatory momentum is likely to be maintained, as more targeted and sweeping reforms are introduced and implemented.

Specific programmes of reform are also underway at the regulators. Particular areas of focus for the FCA are the financial promotions and the appointed representative (AR) regimes.

New rules and guidance to amend the financial promotion approval regime and bolster the rules for high-risk investments will come into effect in February 2023. These changes complement the forthcoming introduction of a new "regulatory gateway" for authorised firms approving financial promotions, which will be aimed at addressing the risks of potential harm to end-investors arising from inappropriate marketing activities. FCA-authorised firms will no longer be able to approve financial promotions on behalf of other organisations by default – instead, firms will need to apply for specific permissions to give such approvals. The FCA's consultation on the gateway rules closes in February 2023, and final rules are expected in the first half of 2023.

We can also expect heightened scrutiny from the FCA on firms that have or intend to have AR arrangements in place. The FCA has sought to bring greater control

over AR arrangements by way of changes to the AR regime that have recently come into effect. Among other new requirements that bolster the oversight of principal firms over their ARs and ensure the adequacy of systems and controls, the changes also implement a pre-notification period of at least 30 days before a future AR appointment takes effect.

These changes to the financial promotions and AR regimes will be a significant shake-up for the business models of regulatory hosting firms.



Finally, in the face of the cost of living crisis, regulators continue their work to enhance regulations from lessons learnt following the pandemic. In the latter half of 2022, the FCA issued a letter on the expectations of insurance firms in relation to vulnerable customers, and published its findings from their examination of consumer credit firms' treatment of borrowers in financial difficulty (BiFD) after the pandemic.

There is likely to be continued review of firms to ensure that they are meeting expectations and providing support to customers in financial difficulty.



## Key trends and issues

- 1** The FSM Bill will result in an overhaul of the UK financial regulatory architecture. In particular, the Bill will establish a framework for the revocation of retained EU law, reform the wholesale markets regulatory framework, implement a regime regulating critical third-party firms, and bring activities involving certain stablecoins into the UK regulatory perimeter. These developments will pose regulatory and commercial challenges to firms following increasing divergence of UK laws from parallel regulations in the EU.
- 2** New rules and guidance amending the financial promotion approval regime and targeting high-risk investments will come into effect in February 2023. In addition, following the forthcoming introduction of a new financial promotions "regulatory gateway", FCA-authorized firms will no longer be able to approve financial promotions on behalf of other organisations by default – instead firms will need to apply for specific permissions to give such approvals.
- 3** The Edinburgh Reforms will mean that regulatory change continues apace in 2023, with an ambitious laundry list of proposals out for consultation during 2023. Whilst these changes are intended to drive growth and competitiveness in the financial services sector, firms will need to be mindful of compliance implications as consultations on changes are released by HMT.



# Timeline

Timeline			<div>UK</div> <div>The FSM Bill</div> <div>Parliament will continue its consideration of the FSM Bill.</div>		<div>UK</div> <div>End of the Brexit fund marketing transitional regime</div> <div>The temporary marketing permissions regime, which allows certain EEA-based investment funds to continue to be marketed in the UK while UK marketing recognition is sought, will end on this date.</div>
	2023	2023	H1 2023	BY END 2023	31 DEC 2025
	<div>EU &amp; UK</div> <div>Post-Brexit cooperation</div> <div>The UK and EU may publish their long-awaited memorandum of understanding establishing structured regulatory cooperation on financial services.</div>	<div>UK</div> <div>Reform of the AR regime</div> <div>The FCA plans to publish its feedback on potential areas of policy change relating to the AR regime. Potential business models and practices which could be considered for reform include regulatory hosting models, smaller principals with large ARs, overseas ARs and prudential standards for principals.</div>	<div>UK</div> <div>Edinburgh Reforms</div> <div>HMT has stated that it expects to make significant progress by end 2023 on the first two tranches of its programme to repeal and replace retained EU law on financial services. Tranche 1 work has already begun, covering the Wholesale Markets Review, Lord Hill’s Listing Review, the Securitisation Review and the review into the Solvency II Directive. Tranche 2 will include the following files:</div> <div><div><div>▪ The remaining implementation of the outcomes of the Wholesale Markets Review (including reforming parts of the MiFID framework)</div><div>▪ Continuing with the review of Solvency II</div><div>▪ PRIIPs Regulation</div></div><div><div>▪ Short Selling Regulation</div><div>▪ Taxonomy Regulation</div><div>▪ Money Market Funds Regulation</div><div>▪ Payment Services Directive and the E-Money Directive</div><div>▪ Insurance Mediation and Distribution Directives</div></div><div><div>▪ Capital Requirements Regulation and Directive</div><div>▪ Long-Term Investment Funds Regulation</div><div>▪ The consumer information rules in the Payment Accounts Regulation</div></div></div>		



# Markets, Funds and Investments

Following on from the turmoil of rapid response regulation to the pandemic in 2021, 2022 saw both the UK and the EU begin to implement reform programmes in parallel across a number of different wholesale sectors. This year is set to see these reform programmes progress, with firms operating cross-border potentially becoming subject to increasingly complex and divergent requirements.

In the UK, the biggest collection of reforms on the agenda for the wholesale sector is the Edinburgh Reforms package of regulatory proposals. Among the measures to look out for are reforms to the Securitisation Regulation and Short Selling Regulation; the repeal and replacement of a number of retained EU law regimes including the PRIIPs regime, the Money Market Funds Regulation and the Long Term Investment Funds Regulation; bringing forward reforms from the Wholesale Markets Review; and implementing a regime for a UK consolidated tape by 2024. HMT expects to make significant progress on the first two tranches of its EU financial services files by the end of 2023, though there is some question as to how ambitious this timeline will prove to be.

Looking first at the reform of wholesale markets, initiatives in both the EU and the UK are set to advance in 2023. The EU Commission launched its proposals to update the MiFID II regime in November 2021, focusing on improvements in efficiency, data access and transparency.

The UK's Wholesale Markets Review proposals to overhaul MiFID II followed in 2022, with many of the specific reforms set out in the FSM Bill along with a host of other measures revoking retained EU law and moving the regulatory frameworks to the FSMA-based regulatory model.



The key question for firms is, to what extent will the EU and UK changes diverge? The proposed reforms are, by and large, quite similar in what they try to address. Interestingly, while the UK's proposals sit within the wider context of post-Brexit policy direction and reforms tailored to UK markets, some of the floated changes have influenced the EU's proposed measures, as the EU seeks to ensure that their MiFID regime remains competitive going forward. The UK has been able to move more quickly and ambitiously, as to be expected with fewer stakeholders involved in negotiations, with bigger ticket reforms suiting the push for outcomes-based regulation – for example, the FCA has already modified the share trading obligation (STO) and suspended the double volume cap (DVC), both of which are set to be repealed via the FSM Bill. EU policymakers, in turn, are proposing technical tweaks rather than the more extensive UK reforms, but have begun to consider incorporating some of the UK's proposals into the MiFID II reform package, with the European Parliament's ECON committee proposing amendments that would suspend the DVC for at least five years (and the Council of the EU proposing instead a move to a single volume cap). The FSM Bill is expected to complete its passage through Parliament in early 2023. In the EU, trilogue negotiations on the MiFID II reform package are likely to start in the second

quarter of 2023 after the European Parliament adopts its negotiating position, with some expecting the package to be adopted by the end of the year.

Staying with the MiFID II regime, firms will also need to prepare for the forthcoming expiry in July 2023 of the US Securities and Exchange Commission's (SEC) no-action relief relating to the MiFID II inducements regime. In November 2019 the SEC announced an extension of the SEC staff "no-action letter" on research payments, which addresses the potential conflict between US regulation and MiFID II, until 3 July 2023. During the remainder of the period of the no-action relief, broker-dealers subject to the US regime may receive payments for unbundled research from firms subject to MiFID II or equivalent rules of EU member states without being considered an investment adviser under US law.

We may also see further reforms to the securities settlement discipline regime under the Central Securities Depositories Regulation (CSDR). The mandatory buy-in provisions were delayed again in October 2022 in response to growing industry pressure and potential amendments to the mandatory buy-in rules in the CSDR Refit proposal; the provisions are now due to apply on 2 November 2025.

However, there is pressure from other EU political institutions and regulators to remove the mandatory buy-in regime in its entirety; the European Central Bank issued an opinion in July 2022 recommending the removal of mandatory buy-ins altogether, and ECON's draft report on CSDR Refit suggested discarding the mandatory buy-in regime in favour of reintroducing into the Short Selling Regulation the central counterparty (CCP) buy-in provisions against naked short-selling that already existed prior to CSDR. CSDR Refit is expected to progress to trilogues in 2023 and it seems likely that changes will be made to the mandatory buy-in regime given the lack of political support.

In the EU, reforms to the European Market Infrastructure Regulation (EMIR) are also on the horizon. In an attempt to avoid what it views as "excessive" reliance on UK central counterparties (CCPs), encourage clearing in the EU and improve the attractiveness of EU CCPs post-Brexit, in December 2022 the EU Commission published a proposal to amend EMIR, dubbed "EMIR 3". The most controversial of the provisions amending the clearing framework relate to active accounts and clearing through EU CCPs: under EMIR 3, counterparties to derivative transactions which are subject to the clearing obligation will need to hold active accounts, directly or indirectly, with



EU CCPs, and will need to clear at least a proportion of their derivatives with them. In the UK, EMIR was not included in the Edinburgh Reforms package and consequently any reforms to the UK clearing framework are unlikely to be a priority, though some in the industry have urged HMT and the regulators to put forward changes that would better align the UK regime with the EMIR 3 proposals.

In the funds spa the proposed revisions to the Alternative Investment Fund Managers Directive (AIFMD II), key developments to watch in the EU include the progression of AIFMD II, with enhanced delegation reporting a key proposal to watch (though, in a welcome move for the industry, not the more onerous delegation approval requirements originally floated by ESMA in the wake of Brexit).

Progress has been slow and somewhat delayed, but we expect trilogue negotiations to commence in 2023. In the UK, we expect to see further movement on the long-awaited Overseas Funds Regime, with HMT having commenced its equivalence assessment of the EU and EEA in October 2022 and the FCA due to consult on operationalising the regime in 2023. We may also see further scrutiny of the regulatory hosting model, following indications from HMT and the FCA in their recent reforms to the AR regime that they have concerns about sufficient oversight expertise, resource challenges and potential conflicts of interest. Finally, in the aftermath of the September 2022 UK gilt market volatility surge, we may see further moves to bring investment consultants within the regulatory perimeter, an outcome recommended by the FCA a number of times over the past few years.



## Key trends and issues

- 1** Wholesale reforms in the EU and UK are progressing in parallel, but with different aims and potentially different outcomes leading to increasing divergence. For businesses operating cross-border, navigating these reforms, and the resultant compliance obligations, will become increasingly complex. Firms will also need to prepare for the expiry on 3 July 2023 of the SEC's "no action" relief on MiFID II inducements and research provisions.
- 2** In particular, firms should be on the lookout for the removal of PRIIPs Key Information Documents (KIDs) in the UK and possible changes to Short Selling Regulation reporting thresholds following HMT's call for evidence.
- 3** In the funds space, trilogue negotiations are set to continue in 2023 on the AIFMD II proposal. In the UK, 2023 may see the long-awaited Overseas Funds Regime finally take shape. We may also see further scrutiny of the regulatory hosting model and a push to bring investment consultants within the regulatory perimeter.

# Timeline

Timeline																																													
EU		CSDR Refit		Trilogue negotiations are expected to commence on the proposed CSDR Refit Regulation.		Cross-border fund marketing		ESMA is undertaking a number of workstreams relating to fund marketing in 2023, including regulatory technical standards (RTS) on the notifications for cross-border marketing and management of AIFs and UCITS and a report on national rules on the marketing of investment funds.		International		Fund liquidity		The Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) will undertake a number of workstreams relating to fund liquidity, including a revision of the 2017 FSB recommendations on liquidity mismatch in open-ended funds and guidance on liquidity management tools.		EU		Market outages		ESMA is expected to publish final guidance on communication protocols and related arrangements for trading venues in the event of an outage. The guidance will apply to equity markets and, where applicable, to non-equity instruments.		UK		Wholesale Markets Review		The FCA is expected to publish final rules and guidance clarifying the regulatory perimeter for trading venues as part of the Wholesale Markets Review.		USA		Expiry of SEC “no action” relief on MiFID II inducements and research provisions		The SEC’s “no-action letter”, which addresses the potential conflict between US regulation and MiFID II inducements and research provisions, will expire on 3 July 2023. During the period of the no-action relief, broker-dealers subject to the US regime may receive payments for unbundled research from firms subject to MiFID II or equivalent rules of EU member states without being considered an investment adviser under US law. This also applies to UK firms.		EU		CSDR mandatory buy-in regime		The delayed mandatory buy-in rules under the CSDR settlement discipline regime take effect.							
2023		2023		2023		2023		2023		2023		Q1 2023		Q1 2023		17 FEB 2023		Q2 2023		18 JUN 2023		3 JUL 2023		29 APR 2024		2 NOV 2025																			
UK		Overseas Funds Regime		HMT is expected to progress equivalence decisions under the Overseas Funds Regime during 2023, while the FCA will continue its work to operationalise the framework.		EU		MiFID marketing review		ESMA’s common supervisory action on financial product marketing and MiFID II disclosure will be conducted over the course of 2023.		AIFMD II		Trilogue negotiations will continue on AIFMD II. Once adopted, EU member states are expected to have two years to transpose AIFMD II into national law.		EU		Reverse solicitation		The EU Commission may publish its long-delayed report on reverse solicitation and demand on the own initiative of an investor, originally due in August 2021. Reporting gaps and data collection difficulties have made the analysis difficult, and ESMA suggested in December 2021 that the Commission may wish to consider introducing reporting requirements relating to reverse solicitation.		UK		LDI portfolios		The FCA intends to publish a statement of good practice on risk management and operational governance of LDI portfolios.		EU		MiFID II passporting		ESMA’s consultation on revised technical standards for passporting under MiFID II closes to comments. The consultation proposes to add a number of items to the information that investment firms are required to provide at the passporting stage. Final technical standards are expected by the end of 2023.		EU		EMIR exemption for pension scheme arrangements		The exemption to the EMIR clearing obligation for pensions scheme arrangements expires on this date.		EU		EMIR derivatives trade reporting		ESMA guidelines harmonising and standardising derivatives trade reporting under EMIR apply from this date.	





# ESG

Over the past year capital has continued to flow into sustainable and “ESG”-friendly investments - driven in part by a substantial set of new rules and regulations impacting both the regulated and unregulated sectors. As with all significant regulatory change there is an adjustment period, where market participants review and amend their approach in view of an increasingly complex global regulatory and enforcement environment.

The EU has been instrumental in reshaping the sustainable investing landscape, through introducing new pieces of legislation including the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, and amending key parts of the existing regulatory framework such as MiFID II and the AIFMD. Suitability disclosures have been in place since 1 January 2023 - firms within scope of the SFDR with products that promote environmental or social characteristics, or that have sustainable investments as their objective, are now required to make detailed sustainability disclosures on standardised templates. Many firms making these disclosures will also need to demonstrate how their investments align with the Taxonomy Regulation. Until now it has been difficult for

some market participants to accurately judge the appropriate sustainability categorisation for their products, and we therefore expect these disclosures to trigger further adjustments within the regulated sector as participants gain access to granular data from across the market. It is also increasingly clear that EU authorities expect market participants to proactively source data for their disclosures, and that such data must be accurate - failure to collect adequate data is likely to have a significant impact on firms’ sustainability disclosures.



Regulatory change at the EU level will continue apace in 2023 - certain gas and nuclear power activities have been brought within scope of the Taxonomy Regulation; ESMA is considering how sustainability language should be used in financial product names; and firms falling within scope of the Corporate Sustainability Reporting Directive (CSRD) will be required to collect and disclose far greater quantities of data than previously. However, firms prioritising social investment strategies will need to wait for news on progress towards the EU's Social Taxonomy, which stalled somewhat in the second half of 2022.

The UK is also moving forward with its own ESG package comprising product and firm-level disclosures, new requirements on product distributors, the use of sustainable investment labels as well as rules on naming and marketing in-scope products. As part of these measures the FCA is also proposing to introduce a general anti-greenwashing rule to clarify that sustainability-

related claims must be clear, fair and not misleading. The UK is also developing its own version of the EU's Taxonomy Regulation, although progress on this has been paused since the government announced in December 2022 that it is "reviewing its approach to taxonomy development", and it is not yet clear to what extent the UK Taxonomy will diverge from the EU's.

These measures are being implemented alongside the FCA's regime for climate-related financial disclosures (applicable to certain life insurers and FCA-regulated pension providers (termed together as "asset owners") as well as certain asset managers). The deadline for certain large asset managers and asset owners to publish their first set of disclosures is 30 June 2023. Other asset managers and asset owners within scope of the regime will need to ensure that they have begun to collect data from 1 January 2023, with a view to making disclosures by 30 June 2024.

On the banking side the PRA will continue to work with banks and insurers on assessing climate-related financial risks. The PRA's recent Dear CEO letter published in October 2022 highlighted that whilst "governance of climate risks has advanced in most firms... levels of embedding may vary and the assessment of supervisors is that further progress is needed by all firms".

The sector has seen a marked increase in regulatory enforcement over the past year, and this is expected to continue into 2023. Whilst the focus to date has been on greenwashing, the market is also voicing concerns around green bleaching (where market participants invest into sustainable activities but refrain from categorising their products correctly, so as to avoid the disclosure obligations), although it remains to be seen how regulators tackle this particular challenge.



## Key trends and issues

- 1** The pace of regulatory change will continue into 2023, and firms will need to navigate increasingly complex sustainability regimes (particularly in relation to their cross-border operations). A significant number of market participants will be required to make more granular sustainability disclosures in 2023, and this will provide firms with helpful context in assessing the sustainability categorisation of their own products. We also expect to see other financial centres, such as the United States, enact their own disclosure regimes.
- 2** EU regulators have made clear their expectation that market participants must proactively source data for their sustainability disclosures, and, where no data is available, firms may have to disclose the lack of alignment against the Taxonomy Regulation. However, data availability is set to improve markedly as more firms are brought within scope of the CSRD.
- 3** Regulatory enforcement activity is also expected to increase, although it remains to be seen how regulators will deal with the newer issue of "green bleaching". We also expect to see an uptick in litigation relating to sustainability regulations, particularly as shareholders become increasingly engaged in companies' ESG credentials.



# Timeline

Timeline												
			<b>UK</b>  ESG data and ratings providers code of conduct  The ESG Data and Ratings Code of Conduct Working Group (DRWG) industry group is expected to consult on a draft voluntary Code of Conduct for ESG data and rating providers, with a final Code to follow four months later. While HMT considers whether to regulate ESG data and ratings providers, the Code will function as an interim measure, and should the regulatory perimeter be expanded the Code may also continue to apply for ESG data and ratings providers that fall outside the scope of potential future regulation.	<b>UK</b>  Regulation of ESG data and ratings providers  HMT is expected to consult on bringing ESG data and ratings providers into the regulatory perimeter.	<b>EU</b>  ESG-related terms in fund names  ESMA's consultation on guidelines on the use of ESG or sustainability-related terms in fund names closes to comments. The guidelines propose quantitative and qualitative thresholds for the use of related terms, and minimum safeguards including exclusion criteria. Final guidelines are expected in Q2 or Q3 2023.	<b>EU</b>  SFDR PAI statements  Financial market participants must make their first principal adverse impacts (PAI) statement under the SFDR RTS by this date, covering the period from 1 January to December 2022.	<b>EU</b>  Delayed report on SFDR RTS amendments  The ESAs are expected to submit their delayed report to the Commission on amending the SFDR RTS to reflect PAI indicators and enhanced transparency relating to financial products.	<b>EU</b>  Climate disclosures by smaller asset managers and asset owners  Smaller asset managers and asset owners must publish their first set of climate-related disclosures under the FCA rules by this date.				
2023	2023	H1 2023	EARLY 2023	Q1 2023	25 JAN 2023	20 FEB 2023	30 JUN 2023	30 JUN 2023	SEP 2023	NOV 2023	FROM 1 JAN 2024	30 JUN 2024
<b>UK</b>  UK Green Taxonomy  Following its decision to review its approach to the development of the UK Green Taxonomy and repeal the statutory requirement to make technical screening criteria regulations by 1 January 2023, HMT will consider how to use the powers in the FSM Bill to restate and modify retained EU law and decide whether to change its approach.	<b>EU</b>  Greenwashing  The European Supervisory Authorities (ESAs) will launch a common supervisory action in the area of sustainability, covering the risk of greenwashing of sustainable investment management products.	<b>UK</b>  Updated Green Finance Strategy  Following its May 2022 consultation, the government is expected to publish an updated Green Finance Strategy early in 2023, which will include an update on the review of its approach to the UK Green Taxonomy.	<b>UK</b>  SDR and labelling regime consultation  The FCA's consultation on sustainability disclosure requirements (SDR) and investment labels, including the introduction of a general anti-greenwashing rule, closes to comments.	<b>UK</b>  SDR and labelling regime final rules and guidance  The FCA intends to issue final rules and guidance on the SDR and investment labels, including the introduction of a general anti-greenwashing rule.  Climate disclosures by large asset managers and asset owners  Large asset managers and asset owners must publish their first set of climate-related disclosures under the FCA rules by this date.	<b>International</b>  TNFD reporting framework  The final recommendations of the Task Force on Nature-related Financial Disclosures (TNFD) for a framework for nature-related risk management and disclosures is expected to be published.	<b>EU</b>  CSRD begins to apply  CSRD requirements begin to apply on a staggered basis, starting with large public-interest companies (with over 500 employees) for financial years starting on or after 1 January 2024.						

London Financial Institutions Regulatory and Enforcement

25





# Risk, Governance and Oversight

As highlighted by the FCA in its Strategy 2022 to 2025 document, firms' culture and governance can be the root cause of both harm and of positive outcomes. It is therefore unsurprising that risk management, governance and oversight continue to stay high on the regulatory agenda and developments in this area evolve rapidly and towards new directions.

Operational resilience remains an important cross-cutting focus, with final rules from the FCA and PRA on operational resilience requirements for firms and financial market infrastructures (FMIs) in application since March 2022. These final rules are a step change in regulation, imposing key new requirements on setting impact tolerances, engaging in scenario testing and self-assessment, and establishing robust related governance arrangements. Firms and FMIs are now required to undertake mapping and testing exercises in order to demonstrate, no later than 31 March 2025, that they are able to remain within impact tolerances for each important business service. Recently, the PRA's Executive Director for Supervisory Risk Specialists, Duncan Mackinnon, noted that firms need to use wisely the time they have left until March 2025 to address any vulnerabilities and enhance their operational resilience, and warned that the longer it takes firms to

map to the required level of sophistication and to run robust scenario tests, the shorter the time they'll have to achieve these objectives.

Similarly, the EU has adopted the Digital Operational Resilience Act (DORA), which will create granular, prescriptive and uniform requirements in respect of cybersecurity, operational continuity and the resilience of a firm's network and information systems. These requirements are rather extensive, ranging from the requirement to introduce new systems and controls, risk management frameworks, policies and contractual provisions. In recognition of the time it will take for firms to be DORA-compliant, the regulation includes a two-year implementation window with the new rules taking effect on 17 January 2025. And as we explain further in Tech, Innovation and Data, the focus has now turned to the resilience of third-party firms.

Turning to governance, the FCA will continue to focus on the key culture drivers for firms and their effectiveness in reducing potential harm from firms' business models and strategies, in particular through recovery from the pandemic and as the cost of living crisis continues to affect consumers and businesses alike. Solo-regulated firms will need to continue to take on board lessons from their dual-regulated counterparts and ensure the right "tone from within" in embedding SMCR compliance and good firm culture. As part of the Edinburgh Reforms package, the government intends to launch a review of the SMCR in the first quarter of 2023 considering the regime's effectiveness, scope and proportionality as well as potential improvements and reforms, alongside a parallel review by the FCA and PRA of the regulatory framework.

D&I also ranks high on the agenda of both financial regulators for 2023. As part of embedding good firm culture and improving governance and innovation, the FCA expects firms to consider whether they are sufficiently diverse and inclusive to meet their customers' needs; the FCA is working on a joint approach with the PRA on D&I in financial services, with a delayed consultation and policy statement to come in 2023. In December 2022, the FCA published its findings from a multi-firm review of how firms are designing and embedding D&I strategies and encouraged all regulated firms to consider these findings in the development of their D&I practices.



## Key trends and issues

- 1** The final FCA and PRA rules on operational resilience have been in place since March 2022 and impose a number of new requirements. Firms and FMIs should be able to demonstrate, no later than 31 March 2025, that they are able to remain within impact tolerances for each important business service and they have achieved the required outcome.
- 2** Firms should consider the prescriptive and granular requirements imposed by DORA, and undertake a DORA mapping exercise to identify any gaps between current practices and DORA requirements. Any gaps identified will need to be rectified before the end of the implementation window.
- 3** The Edinburgh Reforms include proposals to begin a review of the SMCR in Q1 2023. The FCA and PRA will review the regulatory framework and a call for evidence will seek views on the regime's effectiveness, scope and proportionality, and on potential improvements and reforms.



# Timeline

Timeline

			<div>EU</div> <div>Fit and proper framework for credit institutions</div> <div>The Council and European Parliament will continue to consider the Commission’s proposals for a Regulation and a Directive amending the Capital Requirements Regulation and Directive. Among the extensive changes proposed, the Directive will establish a fit and proper framework for assessing the suitability of key function holders in credit institutions.</div>		<div>UK</div> <div>Removal of bonus cap</div> <div>The FCA and PRA joint consultation proposing rule changes to remove the existing limits on the ratio between fixed and variable components of total remuneration closes to comments. Final rules, once published, are expected to take effect for most firms on the 2024/2025 performance year. The intention to remove the bonus cap was announced by the government in September 2022 and has since been incorporated into the Edinburgh Reforms package of measures.</div>		<div>UK</div> <div>Operational resilience regime</div> <div>Firms and FMIs must demonstrate, no later than this date, that they are able to remain within impact tolerances for each important business service.</div>
	2023	2023	2023	Q1 2023	31 MAR 2023	17 JAN 2025	31 MAR 2025
	<div>UK</div> <div>SMCR expansion</div> <div>During 2023, HMT and the FCA will continue their work relating to extending the reach of the SMCR to FMIs, payments and e-money firms, recognised investment exchanges and credit ratings agencies. HMT and the FCA will also consider whether to extend the SMCR to ARs.</div>	<div>UK</div> <div>D&amp;I</div> <div>The FCA and PRA are expected to launch their delayed joint consultation on rules relating to D&amp;I in financial services.</div>		<div>UK</div> <div>Review of the SMCR</div> <div>As part of the Edinburgh Reforms, the government intends to launch a review of the SMCR considering the regime’s effectiveness, scope and proportionality alongside a parallel review by the FCA and PRA of the regulatory framework.</div>		<div>EU</div> <div>DORA</div> <div>DORA will take effect on 17 January 2025. Firms in scope will need to identify and rectify any gaps before the implementation window closes.</div>	



# Tech, Innovation and Data

The UK and the EU have both continued to focus on digital operational resilience as a key issue for firms. The policy statements on operational resilience issued by the FCA and PRA are now in effect. As we explain in Risk, Governance and Oversight, UK firms have until 31 March 2025 to map the impact tolerances of their important business services and make the investments necessary to remain within those tolerances. Similarly, at the EU level DORA will take effect on 17 January 2025.

However, regulators no longer consider it sufficient from a systemic risk perspective to limit the oversight of operational resilience solely to regulated entities, and 2022 has seen significant developments in bringing “critical” third party service providers within the scope of direct regulatory oversight. At the EU level, in addition to operational resilience requirements for regulated entities, DORA also creates a framework for the direct oversight of critical third party outsourcing providers of ICT-related services. Further detail on the regime, including the criteria by which service providers will be designated as critical, is to be provided in subsequent Level 2 delegated acts, with technical advice due from the ESAs by the end of September 2023.

Similarly, in the UK, HMT confirmed in June 2022 that it will implement a regime whereby third-party firms designated as “critical” (CTPs) will be subject to direct regulatory oversight

by the financial regulators in order to mitigate the risks caused by financial services firms outsourcing important functions to third-party service providers, and the FSM Bill introduced amendments necessary to establish this new CTP regime. The forthcoming regime seeks to plug the systemic risk gaps left open by the UK’s current operational resilience framework when a third party provides critical functions to multiple firms in the financial services sector. These measures will complement, not replace, firms’ and FMIs’ own responsibilities to manage potential risks to their operational resilience, including as a result of the impact of the failure or disruption of a CTP. A joint discussion paper issued by the UK financial regulators, setting out how they intend to use the powers that they have been granted, closed on 23 December 2022, and further consultations on more granular requirements are expected in 2023. Once the regulatory rules are finalised, HMT will begin designating CTPs under the regime.

In the payments space, the UK has continued to push towards a new payments architecture, currently expected to launch in 2024. At present, it is expected that clearing and settlement of payments will take place over a single purpose-built central infrastructure, which will be developed by Pay.UK, the operator and standards body for the UK's retail interbank payment systems. The Payment Systems Regulator (PSR) has expressed a keen intention to closely communicate with companies that take part in the tender processes launched by Pay.UK, which should help harmonise the development of the infrastructure.

More broadly, the FCA and other regulators around the world continue to grapple with finding balance between fostering innovation and competition, and seeking to ensure customer and market protection against the risks of increased use of technology. This has led to the development of regulatory sandboxes and tech sprints, which will continue in the new year: as announced in the Edinburgh Reforms launch, the government has recommitted to establishing the FMI Sandbox in 2023. The UK financial regulators are also keen to better understand the benefits, challenges and risks arising from the use of artificial intelligence (AI) in financial services – a joint discussion paper considering whether the current set of legal requirements and guidance is sufficient to address the risks and harms associated with AI, and how additional intervention may support the safe and responsible adoption of AI, closes in February 2023. Finally, the FCA has been vocal about its intention to become an innovative, data-led regulator; its new Innovation Advisory Group industry panel will meet for the first time in early 2023.



## Key trends and issues

**1** In both the UK and EU, critical third party providers will be subject to direct regulatory oversight by the financial regulators in order to mitigate the risks caused by financial services firms outsourcing important functions to service providers. Legislation establishing the UK regime is pending, and UK regulators plan to consult on their requirements and expectations for critical third parties in 2023.

**2** In the EU, DORA will take effect on 17 January 2025. Critical third party providers will become subject to direct oversight, and third party providers more generally are likely to see large-scale revisions to their services contracts. Technical advice on the regime is due from the ESAs by the end of September 2023.

**3** The UK regulators continue to explore whether the current regulatory environment is sufficient to address the benefits, risks and harms associated with AI, and whether further intervention may support its safe adoption.



# Timeline

		UK		EU	
		Innovation in regulation		Critical third party classification under DORA	
		The FCA's new Innovation Advisory Group industry panel will meet for the first time in early 2023.		The ESAs are due to submit technical advice to the Commission on the designation criteria and fees for the critical third party oversight framework under DORA.	
2023	2023	EARLY 2023	27 JAN 2023	30 SEP 2023	17 JAN 2025
UK	UK		UK		EU
Critical third parties regime	FMI Sandbox		DRCF workplan		DORA
The FCA, PRA and Bank of England plan to consult on proposed requirements and expectations for critical third parties in 2023.	As part of the Edinburgh Reforms package, the government has recommitted to launching the FMI Sandbox in 2023.		The Digital Regulation Cooperation Forum (DRCF) call for inputs on its workplan for 2023 to 2024 closes to comments.		DORA will take effect on 17 January 2025 - critical third party providers will become subject to direct oversight.





# Crypto

If 2020 was the year that Crypto spurred investment action, then 2022 will be remembered for triggering the “equal but opposite” regulatory reaction. And for good reason. With several high-profile insolvencies and an across-the-board fall in cryptoasset prices, regulators have been reminded of the risks that can accompany financial innovation.

The FCA, alongside HMT and various other government and enforcement actors, have been monitoring developments in crypto markets and considering the regulatory approach to dealing with crypto service providers. The FCA has consistently sought to take a “technology neutral” approach to regulation and has been keen to ensure that any regulatory intervention is measured and proportionate so as to avoid stifling innovation in crypto finance or impeding the development of the UK as a hub for crypto finance. To this end, both the FCA and HMT have launched numerous consultations around expanding the regulatory perimeter, regulating cryptoasset promotions and establishing frameworks for the dissolution and wind down of systemic digital settlement asset firms. This “slow and steady” approach was met with a rude awakening with the sudden insolvencies of late 2022 and spurred a more proactive regulatory approach.

While HMT’s original consultation had focused only on the regulation of stablecoins and certain providers, the government’s recent amendments to the FSM Bill suggest that HMT will be given substantial freedom to amend the regulatory perimeter to include a wide array of cryptoassets beyond solely stablecoins. With these amendments to the FSM Bill, and HMT’s long-awaited, wide-ranging consultation proposing to expand its current proposals to cover this broader range of cryptoassets having launched on 1 February 2023, it is likely that 2023 will be a period of significant regulatory upheaval for cryptoasset service providers. With the FCA appearing to have rejected more than 80% of requests by crypto firms for approval under the money laundering registration regime, it is likely that cryptoasset service providers could face an uphill battle in bringing their systems and controls as well as governance structures in line with regulatory expectations before obtaining any regulatory approval for their activities in the UK.

The FSM Bill will also introduce powers for HMT to produce regulations relating to “digital settlement assets” (DSAs), following HMT’s consultations earlier this year on establishing a “special administration regime” for payment systems using such DSAs. The FSM Bill will introduce amendments to FSMA, the Banking Act and the Financial Services (Banking Reform) Act 2013 to address the supervision and insolvency/administration of certain DSA service providers and systems that utilise DSAs. HMT will also be granted broad powers to introduce new regulations relating to DSAs. These rules are intended to address the systemic risks that may result from the collapse of large stablecoin issuers or systems using or backed by such assets.

With HMT confirming in January 2022 that cryptoassets will be brought within the scope of the financial promotions regime, it is likely that 2023 will also see new rules relating to the promotion and advertising of cryptoassets being introduced. These new rules are expected to be introduced alongside a financial promotions gateway that limits the ability of authorised firms to approve financial promotions. The combined effect of the expansion of the regulatory perimeter and the introduction of the financial promotions gateway (as well as ongoing efforts by the FCA and bodies such as the Advertising Standards Authority to crack down on misleading crypto promotions) are expected to have a chilling effect on the range and number of cryptoasset promotions. Importantly, in welcome news for the industry HMT's policy statement of 1 February 2023 confirms that crypto businesses with current MLRs registrations will be permitted to issue financial promotions relating to their own services, at least on a temporary basis, pending any authorisation under the proposed new regulatory regime. Further, with the events of late 2022 and media reporting on the multiple roles fulfilled by certain crypto providers, it will be interesting to see if HMT reconsiders its initial suggestions that crypto custody promotions will remain outside the promotions regime.

In the EU, the EU Parliament is expected to vote in plenary in April 2023 on the proposed EU Regulation on markets in cryptoassets (MiCA), which will establish a harmonised regime for the regulation of cryptoassets across the EU adapted from the current MiFID II regime. Provisional political agreement was reached in June 2022.

Finally, the Bank of England is continuing to progress with its proposed central bank digital currency (CBDC). While a consultation (following from the earlier discussion paper) was expected in the course of 2022, it is now anticipated that this further consultation will now be released in 2023.



## Key trends and issues

- 1** HMT's wide-ranging consultation on a future financial services regulatory regime for cryptoassets, which will bring a broad set of cryptoassets within the regulatory perimeter, closes to comments on 30 April 2023.

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- 2** HMT's proposed regulations relating to cryptoasset promotions are expected during the course of 2023. With the forthcoming introduction of the financial promotions gateway, it is welcome news that HMT will introduce a temporary bespoke exemption relating to certain cryptoasset promotions, alleviating industry concerns that forthcoming changes to the financial promotions regime would amount to a total ban on cryptoasset promotions.

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- 3** Continued tweaking to the regulatory regime relating to cryptoassets more generally is expected as market practice reveals weaknesses in the existing regulatory framework. For example recent discussions around the high-profile insolvencies in late 2022 has focused on the failure of crypto businesses to retain sufficient client assets or to separate out various functions into ringfenced entities. Any new regulatory regime may very well aim to correct these perceived deficiencies.



# Timeline

Timeline	UK		EU		International		EU		
	Cryptoasset financial promotions		EU cryptoasset transfers		Stablecoin regulation		Cryptoasset classification under MiCA		
	HMT is expected to introduce secondary legislation to bring cryptoassets within scope of the financial promotion regime; once that legislation is finalised, the FCA will publish its final rules for cryptoasset promotions.		The EU Parliament is expected to vote in plenary on the proposed Regulation on information accompanying transfers of funds and certain cryptoassets, which will implement the travel rule for cryptoasset transfers the EU. Provisional political agreement was reached in June 2022.		The Financial Stability Board is expected to finalise updated high-level recommendations on the regulation, supervision and oversight of global stablecoin arrangements.		The EBA is due to submit technical advice to the Commission on criteria for the classification of significant asset-referenced tokens and e-money tokens (as well as fees to be charged).		
	2023	2023	17 APR 2023	17 APR 2023	30 APR 2023	JUL 2023	1 SEP 2023	30 SEP 2023	1 JAN 2025
	UK		EU		UK		UK		International
	Bitcoin		MiCA		Cryptoasset regulation		UK cryptoasset transfers		Prudential treatment of cryptoassets
	The Bank of England and HMT are expected to publish a consultation on the introduction of a CBDC.		The EU Parliament is expected to vote in plenary on MiCA, which will establish a harmonised regime for the regulation of cryptoassets across the EU. Provisional political agreement was reached in June 2022.		HMT’s wide-ranging consultation on a future financial services regulatory regime for cryptoassets, which will bring a broad set of cryptoassets within the regulatory perimeter, closes to comments on 30 April 2023.		The travel rule for cryptoasset transfers comes into force, following a 12 month transitional period to allow cryptoasset businesses to update their systems and controls.		By this date, the Basel Committee on Banking Supervision (BCBS) expects members to have implemented standards on the prudential treatment of cryptoasset exposures.





# Consumer Protection

Developments in the consumer protection space will continue apace in 2023, with proposals from regulators and government intending to improve the protection for consumer users of financial services. As the UK continues to move away from EU standards, regulators and HMT are taking the opportunity to revamp the UK regime, moving away from standardised disclosures towards a more holistic approach to treatment of customers and a focus on targeted warnings for high-risk products.

The headline item for 2023 in the consumer protection space will be the implementation of the FCA's new Consumer Duty in 2023. Following the finalisation of the new rules in July 2022, firms have faced a short timeline to implementation with the FCA expecting firms' Boards (or equivalent management body) to have agreed their implementation plans by the end of October 2022.

Described by the FCA as a "paradigm shift" in how firms engage with retail customers, the FCA's rules require firms to consider the needs, characteristics and objectives of their customers – including those with characteristics of vulnerability – and how they behave, at every stage of the customer journey. As well as acting to deliver good customer outcomes, firms will need to understand and evidence whether those outcomes are being met.

Implementation will continue apace in 2023 and firms' plans should, by now, be sufficiently developed to provide both firms' governing bodies and the FCA with assurance that the expectations set out in the Duty have been carefully considered and will be implemented for new and existing products by the 31 July 2023 deadline.

Financial promotion and disclosures to retail customers continue to be a hot topic for the FCA, with various developments expected in this space. New rules on risk warnings for financial promotions of high-risk investments came into effect on 1 December 2022, with further rules on customer journeys and stronger oversight of firms approving financial promotions due to come into force on 1 February 2023. In parallel, as noted in Crypto, proposals to bring cryptoassets in scope of financial promotion rules and changes to the exemptions available are underway.

As part of the wide-ranging Edinburgh Reforms, HMT has also commenced the repeal of the PRIIPs Regulation, which has long been viewed by UK regulators as providing unhelpful and sometimes misleading information to customers. To replace these measures, the FCA will be empowered to set their own retail disclosure requirements, which are more suited to the UK market. Similarly, customer information requirements in the Payment Account Regulations which have limited relevance in the UK are set to be repealed.

Firms will need to closely follow reforms in these areas to ensure their ongoing compliance with both prescriptive disclosure and financial promotion requirements, as well as their more holistic compliance with the Consumer Duty.

Changes are also expected in the consumer credit space. HMT plans to make changes to the regulatory perimeter to bring some of the current forms of unregulated buy-now-pay-later (BNPL) products within scope of authorisation requirement. Consumer bodies have applied increasing pressure for BNPL to come within regulatory scope. Despite currently being unregulated, the FCA has taken steps in 2022 to apply regulatory scrutiny to these models through clamping down on financial promotions and using its consumer protection powers to require amendments to terms and conditions. We expect to see greater movement in this area in 2023 and business models relying on BNPL exemptions will need to prepare for transition to a regulated model. HMT has also published a long-awaited consultation on the modernisation of the Consumer Credit Act, with responses due by 17 March 2023.

Finally, the government and the PSR continue to be committed to tackling fraud within payment networks. In recent years, “authorised push payment” (APP) scams, where a payer is deceived or defrauded into authorising a payment to a criminal, have increased both in value and volume. As a result, APP fraud continues to be on the agenda going into 2023 as the PSR confirms its position on mandatory reimbursement and cost allocation, and consults on measures relating to reporting.



## Key trends and issues

- 1** The deadline for compliance with the Consumer Duty is fast approaching. Firms need to act quickly to review compliance throughout the customer life-cycle to ensure they are ready by 31 July 2023.
- 2** Financial promotions and disclosures to customers continue to be a focus. New rules on high-risk investments come into effect in February 2023 and further legislative changes and consultations on retail disclosures, approval of financial promotions and promotion of cryptoassets are anticipated.
- 3** Consumer credit is once again in the spotlight. Changes to the regulatory perimeter to bring BNPL products in-scope of regulation are expected in 2023 and wider changes to the Consumer Credit Act are also under consultation.



# Timeline

Timeline														
			EU		UK		UK		UK		UK		UK	
			Retail investment		Promotion of high-risk investments		Retail investment disclosure regime		APP fraud		Consumer Duty		Consumer Duty	
			Following its 2021 consultation on a Retail Investment Strategy for the EU, the EU Commission is expected to launch a legislative initiative to improve the retail investor protection framework.		Following the December 2022 application of the FCA's rules on strengthened risk warnings, the remainder of the FCA's rules setting out stronger financial promotion requirements for high-risk investments take effect from 1 February 2023.		HMT's consultation on the repeal of the UK PRIIPs Regulation and replacement with a new disclosure framework for retail investments closes to comments on 3 March 2023. The FCA's discussion paper on the future disclosure framework for retail investments closes to comments on 7 March 2023.		The PSR is expected to publish final regulatory requirements on mandatory reimbursement and cost allocation.		By this date, manufacturers must have completed all the reviews necessary relating to the implementation of the FCA consumer duty for existing open products and services and shared the information with distributors.		The Consumer Duty begins to apply to new and existing products and services that are open to sale or renewal.	
	2023	2023	Q1 2023	17 JAN 2023	1 FEB 2023	7 FEB 2023	MAR 2023	17 MAR 2023	Q2 2023	Q2 2023	30 APR 2023	H2 2023	31 JUL 2023	31 JUL 2024
	UK		EU	UK	UK	UK	UK	UK	EU	UK	UK	UK	UK	
	BNPL regulation		Reform of EU consumer credit regulation	APP fraud	Financial promotions gateway	Consumer Credit Act reform	Reform of EU payment services regime	BNPL regulation	Consumer Duty					
	HMT is expected to publish a second consultation on BNPL regulation together with draft legislation.		The proposed Directive on consumer credits, which will revise and replace the Consumer Credit Directive, will modernise the current regime, adapt to digitalisation, improve consumer protection provisions, and widen the lending practices within scope (to include, for example, BNPL schemes). Provisional political agreement was reached on 2 December 2022; formal approval and adoption is expected in 2023.	The PSR's consultation on further measures relating to reporting closes to comments.	The FCA's consultation on rules operationalising the new financial promotions gateway closes to comments.	HMT's consultation on reforming the Consumer Credit Act 1974 closes to comments.	The EU Commission is expected to publish a legislative proposal revising the Payment Services Directive.	The FCA is expected to launch a consultation on rules and guidance for the new BNPL regulatory regime.	The Consumer Duty begins to apply to products and services held in closed books.					
	Financial promotion reform													
	Following its December 2021 consultation, HMT is expected to confirm whether it will tighten the exemptions for high net worth individuals, sophisticated investors and self-certified sophisticated investors. HMT is also expected to introduce secondary legislation to bring cryptoassets within scope of the financial promotion regime; once that legislation is finalised, the FCA will publish its final rules for cryptoasset promotions.													



# London Financial Services Regulatory

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