FIG Bulletin

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Contents

General

Future framework for regulation of UK financial services: Treasury Committee report

The House of Commons Treasury Committee has published its [Fifth Report of Session 2021-22] on the future framework for regulating financial services. The report covers the first part of the committee's inquiry in which the committee considered the future of financial services following the Brexit transition period, as well as how financial regulations should be set and scrutinised by Parliament. The committee recommendations include the following:

- the committee agrees with HM Treasury that the body of EU financial services rules that was onshored during the process of leaving the EU should be moved into the regulators' rulebooks. Keeping rules in statute could require Parliament to amend or pass new legislation every time the regulators wish to make changes. This would be resource-intensive and impractical. The regulators have a key role to play in designing and developing the rules with appropriate Parliamentary oversight;
- the committee has not been provided with compelling evidence to justify changing the law to allow ministers the absolute right to see financial services regulators' policy proposals before they are published for consultation. By doing so, the perception of regulatory independence from government could be damaged. Regulators must continue to be free to choose what they share with the Treasury in this respect;
- if done with a deft approach, there may be a role for activity-based principles to allow the government to instruct the regulators, at a more micro-level, how it wishes them to approach specific types of business sector. However, in light of their strategic and operational objectives, combined with remit letters, the creation of too many activity-based principles would add a further layer of issues to which regulators must have regard. Regulating a company as a whole rather than by activity carried out should provide greater flexibility to regulators to respond to new activities as they develop, rather than needing new activity-specific principles or frameworks each time a new activity emerges. The committee will only form a conclusion on this issue after considering the additional detail in the government's next consultation;
- decisions by the Financial Ombudsman Service (FOS) set precedents and form a critical part of the consumer conduct-focused element of the regulatory environment for financial services in the UK. As the aim of HM Treasury's review is to create a more coherent framework for how financial services are regulated, HM Treasury should consider how the decision-making processes of the FOS would interact with the future regulatory framework for the Financial Conduct Authority (FCA). If Parliament itself is to play a role in setting the regulatory principles of the FCA, it needs to be satisfied that the principles which it has set are not being undermined by decisions of the FOS;
- the committee believes that a measure of "ex-ante" scrutiny by Parliament is necessary. However, it does not believe that it would be proportionate for Parliament or its committees to carry out, as a necessary part of the rule-making process, the detailed and comprehensive textual scrutiny that the European Parliament's Economic and Monetary Affairs Committee (ECON) conducts;
- each new proposal by the regulators will be subject to consultation, therefore, effective scrutiny of regulatory proposals should be carried out through a targeted approach. If any matter of public interest were to arise that the committee deemed sufficiently important to scrutinise in more detail, or indeed challenge, it would do so. Such scrutiny would be both "ex-ante" and "ex-post". The committee does not see a clear need for the creation of a new committee or a new independent body to carry out this work. The creation of a new

independent body to assess whether regulators were fulfilling their statutory objectives would not remove the responsibility of the committee to hold the regulators to account, and it would also add a further body to the financial services regulatory regime which it would need to scrutinise; and

- the committee has been consistent in its regular monitoring of the work of the FCA and of the Prudential Regulation Authority (PRA), the extent to which they meet the objectives set for them by Parliament, and their responsiveness to consumer expectations. There is a strong logic in aligning the scrutiny of draft regulations and policy proposals with that of policy implementation and the day-to-day work of the regulators.

Diversity and inclusion in the financial sector: Joint FCA, PRA and BoE discussion paper

On 7 July 2021, the FCA, PRA, and Bank of England (BoE) published a joint discussion paper, DP21/2, setting out policy options to improve diversity and inclusion in financial services. The FCA has also published a review of research literature that provides evidence of the impact of diversity and inclusion in the workplace. It is relevant to **all** FCA/PRA/BoE regulated firms, including small firms and overseas firms operating in the UK. In DP21/2, the regulators explain the context:

> *"Environmental, Social and Governance (ESG) issues are rising to the top of the agenda for corporates, investors and wider society. This will helpfully serve to keep diversity and inclusion at the forefront of the minds of boards, executives and staff. Against this background, we as regulators need to make our expectations of firms clearer and to root them in our statutory objectives, supported by the Public Sector Equality Duty introduced by the 2010 Equality Act. This Discussion Paper is an important step towards making rapid and more substantive progress across the financial sector.*
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> *Diversity and inclusion are critical to our work on culture and governance, particularly for boards and senior management. For the FCA, it will also be based in existing work around the treatment of consumers, including vulnerability and the proposed new Consumer Duty. We expect to see diversity and inclusion become part of how we regulate and part of how the UK financial sector does business. For the Bank of England and the PRA, the key consideration is about the linkage between insufficient diversity and inclusion and groupthink, which can present a serious risk to safety and soundness. Our goal is to see increased diversity and inclusion in financial services translate into safer and sounder firms with better internal governance and risk management, a more innovative industry, and financial products and services that meet the diverse needs of consumers.*
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> *To achieve this, we do not intend to prescribe a "one size fits all" approach to diversity and inclusion but we do believe that policy has an essential part to play in driving change and we want to work with a wide range of stakeholders, within and outside the financial services sector, to understand the best approaches to take."*

In DP21/2, the regulators set out policy options including, among others, the use of targets for representation, measures to make senior leaders directly accountable for diversity and inclusion in their firms, linking remuneration to diversity and inclusion metrics and the regulators' approach to considering diversity and inclusion in non-financial misconduct. They also focus on the importance of data and disclosure in order to enable firms, regulators and other stakeholders to monitor progress. To assess progress the regulators plan to collect data from firms about their workforce. Before this, they will launch a one-off, pilot survey later in 2021, which will help to develop the proposals set out in DP21/2 and test how firms can provide data with a view to considering regular reporting in the future.

Responses to DP21/2 are requested by 30 September 2021. The feedback and data received will be used to develop detailed proposals, with a joint consultation planned for Q1 2022, followed by a policy statement in Q3 2022. The BoE will separately consider how to develop proposals to promote diversity and inclusion for FMIs. The FCA is also considering its approach to diversity in listed firms and will provide more detail on this in the coming months.

PRA regulatory fees and levies: PS15/21

Following its April 2021 consultation paper, CP8/21, the PRA has published a policy statement, PS15/21, on regulatory fees and levies for 2021/22. PS15/21 sets out feedback to its consultation responses and the final fee rates and rules to recover the PRA's annual funding requirement for the financial period 1 March 2021 to 28 February 2022.

The final rules to implement changes to the Fees Part of the PRA Rulebook are set out in the PRA Rulebook: PRA Fees Amendment (No 2) Instrument 2021 (2021/9). The changes come into effect on 8 July 2021.

Designating investment firms: PRA CP15/21

The PRA has published a consultation paper, CP15/21, setting out proposals making minor changes to its policy on designating investment firms. It is relevant to all PRA-designated UK investment firms.

The aim of the proposals is to ensure that the PRA's policy reflects the impact of the new Investment Firms Prudential Regime proposed by the FCA. They also reflect HM Treasury's proposals to revise the Financial Services and Markets Act (PRA-Regulated Activities) Order 2013 (SI 2013/556), which were published on 28 June 2021. The PRA does not expect that firms would incur significant additional costs as a direct result of the proposals.

The proposals in CP15/21 would amend:

- the statement of policy (SoP), "Designation of investment firms for prudential supervision by the PRA"; and
- the definition of Capital Part of the PRA Rulebook.

Comments can be made on CP15/21 until 5 October 2021. The PRA proposes that the resulting changes would take effect on 1 January 2022.

Pre-paid funeral plan providers and firm failures: HM Treasury consultation on role of FSCS and FCA CP21/20

On 5 July 2021, HM Treasury published a consultation paper on the role of the Financial Services Compensation Scheme (FSCS) where a regulated pre-paid funeral plan provider fails.

HM Treasury made legislation to bring the sale and administration of pre-paid funeral plans within the FCA's remit in January 2021. Further legislative changes are required to ensure that, from the date of the new regime (that is, 29 July 2022), the FSCS can operate effectively for the consumers of pre-paid funeral plan contracts if an FCA-regulated provider fails. Therefore, HM Treasury proposes to make a statutory instrument to:

- enable the FCA to make rules that will allow the FSCS to secure continuity of cover for funeral plan holders in appropriate circumstances; and
- enable the FCA to make rules that will give the FSCS further rights in relation to the trust assets and insurance policies backing funeral plans.

Comments can be made on the proposals, and a de minimis impact assessment for the proposal, until 3 September 2021.

Also on 5 July 2021, the FCA published a consultation paper, CP21/20, on the outcomes for consumers in the event of the failure of a pre-paid funeral plan firm, along with additional proposals in relation to its regulation of funeral plans.

The FCA's proposed rules aim to minimise harm to customers if a regulated funeral plan provider fails by ensuring that contracts can be transferred to new providers where possible, and that the FSCS can arrange continuity of funeral plan contracts or pay appropriate compensation if a firm is not able to meet its liabilities. The proposals also aim to mitigate any undue impact on FSCS levy payers by providing the FSCS with additional powers to help it to recover its costs from failed firms.

The FCA asks for feedback on its proposals by 31 August 2021 and aims to make its final rules in Q4 2021.

Regulating pre-paid funeral plans: FCA PS21/8

Following its consultation in CP21/4, the FCA has published a policy statement, PS21/8, on its approach to regulating pre-paid funeral plans. In brief, the new rules aim to introduce high standards in the funeral plans market and require firms to ensure that plans are sold fairly, perform as expected and provide value for money.

The FCA has also published a consultation paper, CP21/20, on the resolution of regulated funeral plan firms and financial services compensation scheme (FSCS) protection, along with additional proposals in relation to its regulation of funeral plans (see above).

HM Treasury made legislation to bring the sale and administration of pre-paid funeral plans within the FCA's remit in January 2021. The new regime will come into force on 29 July 2022. The FCA reminds firms that if they are not authorised or do not become appointed representatives by this date will have to cease trading in relation to funeral plans. From 29 July 2022, it will be a criminal offence for plan providers to carry out funeral plan contracts without authorisation.

The FCA advises firms that want to continue conducting funeral plan activities after regulation comes into force to prepare now so that they can apply for authorisation as soon as possible after the application gateway opens in September 2021. For applications made after November 2021, the application fee will increase by 40%.

Firms are currently regulated on a voluntary basis by the industry-established Funeral Planning Authority (FPA). The FCA anticipates that the FPA will continue as the voluntary industry body responsible for the conduct of prepaid funeral plan providers registered with them, until FCA regulation begins on 29 July 2022.

FCA MoUs and other agreements with overseas regulators

The FCA has published a new webpage on the multilateral and bilateral memoranda of understanding (MoUs) and other agreements it has signed with overseas regulators. The list is not exhaustive, and some agreements are confidential.

LIBOR transition progress: FCA speech

The FCA has published a speech by Edwin Schooling Latter, Director of Markets and Wholesale Policy, on LIBOR transition progress with six months to go. Points of interest from the speech include:

- for LIBOR panels ending in 2021 (that is, GBP, JPY, CHF and EUR), the central challenge remaining is ensuring all legacy contracts that can be converted do convert by end-2021. The next milestone for progress set by the Working Group on Sterling Risk Free Reference Rates (RFRWG) is end-Q3;
- the RFRWG's end-Q3 date is designed to help avoid the risks of getting caught in a pre-Christmas rush where the markets could see a squeeze in IT, legal or other resources, or would simply have too little time to adjust to unexpected hurdles. Accordingly, while there are good reasons why a firm might choose for the actual change of rates payable to take effect only at end-2021 (for example, if they are using SONIA plus the ISDA spread as the future rate), the FCA is encouraging them to establish plans to complete arrangements for this change in good time;
- firms must act now to move their new USD interest rates business to the Secured Overnight Financing Rate (SOFR). While the bulk of outstanding USD swap market positions will be moving to SOFR, the FCA does not want to see transition to new so-called "credit sensitive" rates (such as Bloomberg's Short Term Bank Yield index (BSBY)). UK and US authorities have warned publicly about the risks embedded in such rates, which share many of the same flaws as LIBOR and can have real economic consequences for users. While these rates may look relatively benign in normal market conditions, there can be a painful "sting in the tail" for borrowers at times of stress; and
- the FCA would therefore be concerned about significant use of such rates in UK markets. It is hard to see how it would be suitable to use them in products aimed at less sophisticated borrowers who might not understand the complex and relatively opaque risks they present. Any regulated UK market participants looking to use these credit sensitive rates in UK-based business should carefully consider the risks and raise with their FCA supervisors before doing so.

UK regime for overseas firms: IRSG report

The International Regulatory Strategy Group (IRSG) has published a report on the UK's regulatory regime for overseas firms. The report considers whether the current regime could be improved, with a view to enhancing the UK's global competitiveness. It looks at the regulatory perimeter, the branching regime, the "Overseas Person Exemption", the Financial Promotion Order and the UK equivalence regimes.

The report argues that the UK's regulatory openness needs to be maintained, but with minor improvements the access regimes could help to make the UK more attractive for international firms.

GDPR: European Commission issues Schrems II-proof Standard Contractual Clauses to allow global dataflows

Following the coming into effect of the GDPR three years ago and in light of last year's Schrems II decision, the European Commission has adopted a new set of Standard Contractual Clauses (SCCs) aimed at enabling lawful transfers of personal data to non-EU countries. Read more in our separate briefing: The European Commission issues Schrems II-proof Standard Contractual Clauses to allow global dataflows, and view our webinar: Tackling Uncertainties: Understanding and implementing the new standard contractual clauses.

Taxonomy Regulation: European Commission adopts Delegated Regulation containing disclosure obligations

On 6 July 2021, the European Commission adopted a Delegated Regulation, which supplements Article 8 of the Taxonomy Regulation by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of the Non-Financial Reporting Directive (NFRD) concerning the proportion of environmentally sustainable economic activities in their business, investments or lending activities and the methodology to comply with that disclosure obligation. On the same webpage as the Delegated Regulation, the Commission has also published accompanying annexes and a staff working document.

Article 8 of the Taxonomy Regulation requires large corporates to include in their non-financial statements information on how and to what extent their activities are associated with environmentally sustainable economic activities. The Delegated Regulation specifies the content and presentation of information to be disclosed by non-financial undertakings, asset managers, credit institutions, investment firms, and insurance and reinsurance undertakings. It also sets out common rules relating to key performance indicators.

The Council of the EU and the European Parliament will now scrutinise the Delegated Regulation for a period of four months, extendable once by two months. The Delegated Regulation will enter into force 20 days after its publication in the Official Journal of the EU (OJ). Article 10 provides that it will apply from 1 January 2022 (the particular requirements will depend on the type of entity).

The Commission consulted on the Delegated Regulation in May 2021. Overall, respondents were supportive, although there were some concerns. In the light of these, several amendments have been made to the Delegated Regulation. These are summarised in Annex III of the staff working document, together with a more extensive summary of the feedback.

EU Sustainable Finance Strategy: European Commission communication

Building on, among other things, the 2018 action plan on financing sustainable growth, on 6 July 2021, the European Commission published a communication to the European Parliament, the Council of the EU and the European Economic and Social Committee and the Committee of Regions, together with an annex and staff working document, on a strategy for financing the transition to a sustainable economy. The Commission has also published a factsheet on the new EU sustainable finance strategy.

The new sustainable finance strategy aims to support the financing of the transition to a sustainable economy by proposing action in four areas: transition finance, inclusiveness, resilience and contribution of the financial system and global ambition. It includes six sets of actions (detailed further in the communication) to:

- extend the existing sustainable finance toolbox to facilitate access to transition finance;

- improve the inclusiveness of small and medium-sized enterprises (SMEs), and consumers, by giving them the right tools and incentives to access transition finance;
- enhance the resilience of the economic and financial system to sustainability risks;
- increase the contribution of the financial sector to sustainability;
- ensure the integrity of the EU financial system and monitor its orderly transition to sustainability; and
- develop international sustainable finance initiatives and standards, and support EU partner countries.

The Commission intends to report on the strategy's implementation by the end of 2023.

CRD: EBA guidelines on internal governance

The European Banking Authority (EBA) has published a final report containing updated guidelines on internal governance under the Capital Requirements Directive (CRD). The update considered amendments introduced by CRD V and the Investment Firms Directive (IFD) relating to credit institutions' and investment firms' sound and effective governance arrangements. In particular, this relates to gender diversity, money laundering, financing terrorist risk and the management of conflicts of interest, including in the context of loans and other transactions with members of the management body and their related parties.

The updated guidelines will apply from 31 December 2021.

CRD: ESMA and EBA guidelines on fit and proper requirements

On 2 July 2021, the European Securities and Markets Authority (ESMA) and the EBA published a final report containing updated joint guidelines on the assessment of the suitability of members of the management body and key function holders in accordance with the CRD and the Markets in Financial Instruments Directive (MiFID). The updated guidelines reflect amendments introduced by CRD V and the IFD) and their effect on the assessment of the suitability of members of the management body, in particular with regard to money laundering and financing terrorism risks, and gender diversity.

The updated guidelines will apply from 31 December 2021. The guidelines were originally published in September 2017, but this version will be repealed.

CRD: EBA guidelines on sound remuneration policies

The EBA has published a final report updating its guidelines on sound remuneration policies under the CRD. The update reflects amendments introduced by CRD V, in particular, the requirement that remuneration policies should be gender neutral. The final guidelines also consider supervisory practices and clarify some aspects of retention bonuses and severance pays. The revised guidelines will apply from 31 December 2021 and the original guidance will be repealed on that date.

The revised guidelines also clarify how the remuneration framework applies on a consolidated basis to financial institutions that are subject to a specific remuneration framework (for example, firms subject to the IFD, the Undertakings for Collective Investment in Transferable Securities (UCUTS) Directive or the Alternative Investment Fund Managers Directive (AIFMD)).

IFD: EBA final reports on technical standards on supervisory cooperation

The EBA has published the following final reports on technical standards supplementing the IFD:

- final report on draft regulatory technical standards (RTS) and implementing technical standards (ITS) on information exchange between competent authorities of home and host member states; and
- final report on draft RTS on colleges of supervisors for investment firm groups.

The draft RTS will be submitted to the European Commission for adoption. Following submission, they will be subject to scrutiny by the European Parliament and the Council of the EU before being published in the OJ. The draft ITS will be submitted to the Commission for endorsement before being published in the OJ.

Data pooling, analytics and data protection: FATF report

The Financial Action Task Force (FATF) has published a stocktake report on data pooling, collaborative analytics and data protection. The FATF states that, through a questionnaire, engagement with public and private sector experts, and a review of case studies, this stocktake examines commercially available or emerging technologies that facilitate advanced anti-money laundering (AML) and counter-terrorist financing (CTF) analytics within regulated entities or collaborative analytics between financial institutions, while respecting data privacy and protection. It also includes an analysis of the intended objectives and drivers for the use of these new technologies and identifies policy considerations and potential solutions raised by questionnaire respondents and experts when considering or deploying such technologies. The FATF acknowledges that AML/CFT, and data privacy and protection, are both significant public interests that serve important objectives, which are neither in opposition nor are inherently mutually exclusive.

A list of actions to support the use of new technologies for AML and CTF has been published alongside the report. These focus on ensuring privacy and data protection when implementing new technologies and developing regulatory approaches that are technology-neutral and in line with a risk-based approach.

The FATF plans to continue working with supervisors, technology developers and financial institutions to ensure that new technologies can contribute to AML and CTF work, consistent with data protection frameworks.

Opportunities and challenges of new technologies for AML and CTF: FATF report

The FATF has also published a report on opportunities and challenges of new technologies for AML and CTF. The FATF explains that new technologies have the potential to make AML and CFT measures faster, cheaper and more effective. requirements, or innovative ways to use established technology-based processes to comply with AML and CFT obligations. They can improve the implementation of FATF Standards to advance global AML/CFT efforts, ensure financial inclusion and avoid unintended consequences such as financial exclusion.

The report identifies challenges related to the development, adoption and application of these innovative solutions or practices. The FATF notes that, when used responsibly and proportionally, innovative AML/CFT technologies can help identify risks and focus compliance efforts on existing and emerging challenges, but manual review and human input remains very important. The development, adoption and regulatory supervision of these technologies must reflect threats as well as opportunities. It must also ensure that the use of innovative tools is compatible with international standards of data protection, privacy, and cybersecurity.

AML and CTF standards on virtual assets and virtual asset service providers: FATF report

The FATF has published a report on the findings from its second 12-month review of its revised AML and CTF standards on virtual assets (also known as cryptoassets) and virtual asset service providers (VASPs). The review looks at how jurisdictions and the private sector have implemented the revised standards since the FATF's first 12-month review in July 2020. It also looks at changes in the typologies, risks and the market structure of the virtual assets sector.

The report finds that many jurisdictions have continued to make progress in implementing the revised FATF standards. 58 out of 128 reporting jurisdictions have implemented the revised FATF standards, with 52 of these regulating VASPs and six of these prohibiting the operation of VASPs. The other 70 jurisdictions have not yet implemented the revised standards in national law. These gaps in implementation mean that there is not yet a global regime to prevent the misuse of virtual assets and VASPs for money laundering or terrorist financing.

Although the supervision of VASPs and implementation of AML/CFT obligations by VASPs is generally emerging, the FATF notes that there is evidence of progress. In particular, there has been progress in the development of technological solutions to enable the implementation of the "travel rule" for VASPs. The travel rule is a key AML/CFT measure, which mandates that VASPs obtain, hold and exchange information about the originators and beneficiaries of virtual asset transfers. The FATF states that the lack of implementation of travel rule requirements by jurisdictions is acting as disincentive to the private sector, particularly VASPs, to invest in the necessary technology solutions and compliance infrastructure to comply with it.

The FATF states that all jurisdictions need to implement the revised FATF standards, including travel rule requirements, as quickly as possible. It will undertake the following actions focused on virtual assets and VASPs. The FATF will:

- focus on implementing the current FATF standards on virtual assets and VASPs, including through finalising the revised FATF guidance on virtual assets and VASPs by November 2021;
- accelerate the implementation of the travel rule; and
- monitor the virtual asset and VASP sector, but not further revise the FATF standards at this point in time (except to make a technical amendment regarding proliferation financing).

LIBOR transition: FSB progress report

The Financial Stability Board (FSB) has published a progress report to the G20, on LIBOR transition issues. The report highlights messages including the following:

- with cessation timelines confirmed, there should be no remaining doubts as to the urgency of the need to transition away from LIBOR by the end of 2021. It is emphasised that the continuation of some key USD LIBOR tenors through to 30 June 2023 is intended only to allow legacy contracts to mature, as opposed to supporting new USD LIBOR activity. A smooth and orderly transition requires, at a minimum, steps to stop issuance of new products linked to LIBOR and efforts to transition away from LIBOR in legacy contracts wherever feasible;
- supervisory authorities should step up their efforts for active and adequate communication to increase awareness of the scope and urgency of relevant LIBOR transitions for all clients and other market participants. Financial institutions and non-financial institutions need to accelerate adoption of risk-free rates (RFRs) in new

contracts, acceptance of newly developed products, as well as active conversion of legacy LIBOR-referencing contracts to directly reference RFRs or insertion of robust fallback language;
- market participants must not wait for development of additional tools to transition away from LIBOR and need to be transitioning to reference rates that are compatible with financial stability and do not reintroduce the vulnerabilities seen with LIBOR to support sustained financial stability; and
- collaboration and co-ordination remain crucial in expediting the transition progress. The FSB encourages authorities to set globally consistent expectations and milestones that firms will rapidly cease the new use of LIBOR, regardless of where those trades are booked or in which currency they are denominated.

The report concludes by stating that, as some of the most widely used USD LIBOR settings will only cease after the end of June 2023, the focus of the FSB's next steps on further monitoring will be remaining issues associated with LIBOR transition after the end of 2021. The FSB will review these issues in mid-2022 and assess the implications for supervisory and regulatory co-operation.

Addressing climate-related financial risks: FSB roadmap

The FSB has published a roadmap for addressing climate-related financial risks. The roadmap outlines the work currently being undertaken as well as what is still to be done by standard-setting bodies and other international organisations over a multi-year period in four key areas: disclosures, data, vulnerabilities analysis, and regulatory and supervisory approaches. It is accompanied by the following reports:

- a report on availability of data to monitor climate-related financial stability risks and remaining data gaps; and
- a report on promoting climate-related disclosures.

The FSB will present the roadmap for endorsement by the G20 Finance Ministers and Central Bank Governors at their meeting on 9 and 10 July 2021.

Banking and Finance

Internal ratings based UK mortgage risk weights: PRA PS16/21

Following its consultation in CP14/20, the Prudential Regulation Authority (PRA) has published a policy statement, PS16/21, on new expectations on internal ratings based (IRB) UK mortgage risk weights. PS16/21 gives feedback to the consultation and sets out the PRA's final policy in this area in the form of an updated supervisory statement (SS), SS11/13: Internal Ratings Based (IRB) approaches. The amendments to SS11/13 will take effect from 1 January 2022.

Respondents to CP14/20 were generally not in favour of the proposed minimum expectations on mortgage risk weights applying to all levels of consolidation and to all UK residential mortgage exposures, including buy-to-let. Particular concerns were raised about the proposed 7% risk weight minimum expectation for individual UK mortgage exposures.

In response to the feedback, the PRA has made two changes to the draft policy as consulted on:

- it will not introduce the proposed 7% minimum risk weight expectation on individual UK mortgage exposures. Instead, it will carefully consider the calibration of the incoming probability of default (PD) and loss given default (LGD) parameter floors for mortgage exposures as part of its implementation of the Basel 3.1 standards; and
- mortgage exposures classified as in default will be excluded from the 10% average minimum risk weight expectation.

The PRA explains that not introducing the minimum risk weight expectation on individual UK mortgage exposures will mean those mortgage risk weights below the proposed value will continue to be permitted. Firms that would have been impacted by the proposal through increases to their mortgage risk weights and corresponding capital requirements will no longer be impacted by it.

Basel reforms: BCBS report on early lessons from COVID-19 pandemic

The Basel Committee on Banking Supervision (BCBS) has published a report, Early lessons from the Covid-19 pandemic on the Basel reforms, giving a preliminary assessment of the impact of implemented Basel reforms during the COVID-19 pandemic, as part of a broader evaluation of their effectiveness.

Overall, the report finds that the increased quality and higher levels of capital and liquidity in the global banking system since the adoption of the Basel III reforms helped banks absorb the significant impact of the COVID-19 shock, suggesting that the reforms have achieved their broad objective of strengthening the resilience of the banking system. It also notes that throughout the pandemic, banks continued to lend and provide other critical services.

The interim report is part of the BCBS's broader work programme to evaluate its post-global financial crisis reforms. It highlights a number of areas that the BCBS intends to continue to monitor. The analysis will be updated and included, as relevant, in a more comprehensive evaluation report covering the Basel reforms implemented over the past decade. The BCBS intends to publish this in 2022 as additional data on the impact of the COVID-19 pandemic becomes available.

Securities and Markets

Listing regime: FCA Primary Markets Effectiveness Review

The Financial Conduct Authority (FCA) has published a consultation paper, CP21/21, seeking views on how primary markets can work more effectively for both companies and investors. The consultation forms part of the FCA's response to the UK Listing Review, chaired by Lord Jonathan Hill, and the Kalifa Review of UK FinTech, both of which made recommendations relating to the listing regime.

The paper is divided into two parts. The first part is a discussion on the purpose and value of the listing regime which is intended to inform the FCA how the listing regime may be made more efficient and accessible, while keeping high standards. The second part consults on the following targeted changes to the existing listing regime to remove barriers to listing and to improve the accessibility of the FCA handbook:

- allowing dual class share structures within the premium listing segment in certain limited circumstances;
- as part of the eligibility criteria set out in the Listing Rules, reducing the amount of shares an issuer is required to have in public hands (i.e. free float) from 25% to 10%;
- increasing the minimum market capitalisation threshold for both the premium and standard listing segments for shares in companies other than funds from £700,000 to £50 million; and
- making several minor changes to the Listing Rules, Disclosure Guidance and Transparency Rules and the Prospectus Regulation Rules to ensure they are simplified where appropriate and reflect current business practices.

The FCA explains that it also considered making changes to the premium listing segment eligibility criteria in the Listing Rules, for the track-record requirements. Although it has concluded that it would not be appropriate to propose specific rule changes at this time, the FCA clarifies its expectations in this paper and seek views on whether changes are needed.

The consultation closes on 14 September 2021 and the FCA hopes to make relevant rules by late 2021. It will provide feedback on the discussion subjects and issue a potential further consultation on the wider listing regime changes in due course, if appropriate.

EMIR: European Commission Implementing Decisions on equivalence for third country derivatives regimes

European Commission Implementing Decisions on the equivalence of the regulatory regimes of the following third countries under Article 11 of the European Market Infrastructure Regulation (EMIR) have been published in the Official Journal of the European Union:

- Brazil (Commission Implementing Decision (EU) 2021/1103);
- Canada (Commission Implementing Decision (EU) 2021/1104);
- Singapore (Commission Implementing Decision (EU) 2021/1105);
- Australia (Commission Implementing Decision (EU) 2021/1106);
- Hong Kong (Commission Implementing Decision (EU) 2021/1107); and
- United States (Commission Implementing Decision (EU) 2021/1108).

The Decisions enter into force on 26 July 2021.

Insurance

UK Solvency II review: PRA CP11/21 on reporting (phase 1)

The Prudential Regulation Authority (PRA) has published a consultation paper, CP11/21, on phase 1 of a review of reporting and disclosure requirements under the Solvency II regime. The PRA has developed these proposals in line with HM Treasury's review of Solvency II.

CP11/21 represents the first phase of the PRA's consultation on changes to Solvency II reporting and disclosure requirements. It focuses on proposals to reduce the volume of financial information reported to the PRA, which could potentially be implemented by both the PRA and firms relatively quickly with a low operational impact. These changes are intended to remove duplications and reduce the areas of reporting that are of less relevance to most firms.

The second phase will be a more in-depth review of all the components that make up the UK reporting and disclosure framework, considering reform proposals in other areas of the Solvency II review. This phase could result in more extensive changes in order to deliver an overall framework that can be operated more effectively by the PRA, and more efficiently applied by firms. This second phase will be undertaken over the remainder of 2021, with a view to consulting on additional proposals in 2022.

The proposals in CP11/21 are:

- removing the requirement to report a number of Solvency II Quantitative Reporting Templates for all insurance and reinsurance undertakings;
- the reduction of reporting frequency of the minimum capital requirements collected via S.28 templates from a quarterly to a semi-annual basis;
- the amendment of a reporting proportionality threshold to further exempt reinsurance undertakings from reporting template S.16.01 on annuities stemming from non-life insurance obligations;
- expanding the PRA's modification by consent to waive certain quarterly returns, to firms that the PRA designates as Category 3 under its Potential Impact Framework; and
- amendments to the PRA's supervisory statements, SS11/15, SS40/14, SS 41/15 and SS44/15, and Statement of Policy (SoP), "Interpretation of EU Guidelines and Recommendations: Bank of England and PRA approach after the UK's withdrawal from the EU", to:
  - reflect the above proposed reporting changes;
  - remove sections that are no longer required to be included in the supervisory statements; and
  - clarify references to EU based provisions following the UK's withdrawal from the EU.

The proposed implementation date for the changes would be for quarterly and annual reporting reference dates falling on and after 31 March 2022.

Comments can be made on the proposals until 8 October 2021.

General insurance intermediaries: FCA Dear CEO letter on adequate client money arrangements

The Financial Conduct Authority (FCA) has published a Dear CEO letter sent to general insurance (GI) intermediaries on maintaining adequate client money arrangements. In the letter, the FCA explains that, over the last year, firms have completed the FCA's financial resilience surveys. Based on the results, the FCA followed up with some firms it believed were at risk of failure or of not having adequate financial resources. As part of this work, the FCA reviewed certain GI intermediaries' client money arrangements and identified common shortcomings that may indicate more widespread non-compliance in the sector. In the Dear CEO letter, the FCA sets out the key issues the FCA found from its assessments and its expectations in these areas.

The FCA refers to its letter to GI intermediaries sent in September 2020 reminding them of their client money obligations. It is now again reminding firms holding or controlling client money that they must establish and maintain arrangements to ensure the funds are adequately protected.

Firms should ensure their client money arrangements are in line with the FCA's expectations set out in the Dear CEO letter. The FCA expects firms to review their client money arrangements in light of the issues highlighted in this letter, and to take "robust action", if needed, to ensure that client money is appropriately safeguarded. CEOs should discuss this letter with their firm's Board or equivalent governing body and identify what actions, if any, are needed to ensure their firm has adequate client money arrangements in place. Firms that are required to obtain client money audits should also ensure their auditor is aware of the letter and the material referenced in it.

Non-life underwriting and pricing in light of climate change: EIOPA final report

On 8 July 2021, the European Insurance and Occupational Pensions Authority (EIOPA) published a final report on non-life underwriting and pricing in the light of climate change.

The frequency and severity of natural catastrophes is expected to increase due to climate change. ESMA explains that, as underwriters of natural catastrophe risks, the (re)insurance sector can be particularly impacted by climate change. The increasing risk can lead to insurance coverage becoming unaffordable for the policyholder, widening further the insurance protection gap.

In the report, EIOPA investigates the opportunity for (re)insurers, as risk managers and underwriters, to contribute to climate adaptation and mitigation, supporting the insurability of climate change-related risks. By applying their data, expertise and risk assessment capacity they can incentivise policyholders to mitigate insured risks. Through risk-based pricing, contractual terms, and underwriting strategy, (re)insurers should promote prevention measures for climate change adaptation and/or mitigation. EIOPA calls this "impact underwriting" in light of climate change.

In terms of next steps, EIOPA states that it will:

- identify the concrete areas to further materialise impact underwriting from a prudential and product design perspective, with a focus on climate change adaptation;
- explore the potential appropriateness for a differentiated risk-based Pillar 1 treatment of insurance products related to climate change adaptation, having regard to evidence;
- further investigate the potential for long-term non-life contracts, having regard to the need to develop new products to address the challenges posed by climate change; and
- investigate the potential incorporation of the impact underwriting concept in product design requirements, including through insurance distribution and product oversight and governance requirements.

Solvency II Nat Cat standard formula: EIOPA report on inclusion of climate change

On 8 July 2021, EIOPA published a methodological paper (dated 29 June 2021) on the potential inclusion of climate change in the standard formula under the Solvency II Directive when calculating natural catastrophe (Nat Cat) underwriting risk. In the paper, EIOPA outlines the methodology used so far for the Nat Cat solvency capital requirement (SCR) calibration. It also elaborates on climate change in the EU by analysing which perils and countries are impacted by climate change. In addition, EIOPA explains how to include climate change in the Nat Cat SCR calibration in the standard formula.

EIOPA considers there is a clear need to explicitly consider climate change in the Nat Cat standard formula calibration for the perils and regions identified in the report. Also, it believes there should be a formal approach to reassessing and, where material, recalibrating the Nat Cat SCR parameters on a regular basis.

This forms part of EIOPA's work to integrate ESG risk assessment in the regulatory and supervisory framework.

Funds and Asset Management

AFMs assessment of funds' value: FCA multi-firm review findings

The Financial Conduct Authority (FCA) has published its findings following a review of the processes used by different authorised fund managers (AFMs) when they carry out assessments of value (AoVs or Value Assessments) for the funds they operate. The FCA found that most of the AFMs reviewed had not implemented the AoV arrangements it expects to comply with its rules. Many had not implemented assessments meeting the minimum consideration requirements and several practices fell short of the FCA's expectations.

The FCA states that each AFM Board should consider this review and how they should apply it to the way the AFM conducts future AoVs. Where necessary, the AFM should implement appropriate changes to address shortcomings. The FCA warns that it expects to find firms complying fully with its rules when the FCA next reviews them. It says that this will be within the next 12 to 18 months. The FCA will consider other regulatory tools if it finds firms are not meeting the standards it expects to comply with its rules.

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