LEGAL BRIEFING

Financial Services Regulation 2025 – New Year briefing

8 January 2025

When Chekhov saw the long winter, he saw a winter bleak and dark and bereft of hope. Yet we know that winter is just another step in the cycle of life. But standing here among the people of Punxsutawney and basking in the warmth of their hearths and hearts, I couldn't imagine a better fate than a long and lustrous winter.

Phil Connors, Groundhog Day

Anyone who thinks my story is anywhere near over is sadly mistaken.

Donald Trump

So, as we would like to pretend we predicted in last year's New Year Briefing, we're going to see an old face in the White House with the 45th President soon to become the 47th President. With 78-year old Donald Trump still pledging to make America great again (and with one of his apothegms gracing our New Year Briefing for the second year running), with EU negotiators reportedly looking to require the UK to sign up to the ECJ again (and to give up its fish) in the relationship "reset" talks and with another, back-to-the-past consultation on a UK Green Taxonomy you might be forgiven for thinking that, at times, you're living in some kind of Groundhog Day.

However, to subvert a well-known saying, often the reality is that the more things might appear to stay the same, the more they change. Regulatory change projects – like governments – come and go; but you can be sure that another one will be along in a moment or – like buses – several will come along all at once. AIFMD II, SFDR 2.0, PSD 3 – will the sequels be better in practice than the original? Funny, there was never a sequel to Groundhog Day.

Whether you have a Chekovian view of the future or tend to Phil Connors' optimistic outlook (but without the sarcasm) the rest of the winter and the year beyond will – as our New Year Briefing testifies – be far from dull.

Do you ever have déjà vu? Didn't we just ask you that?

MAIN INDEX

1 UK FINANCIAL SERVICES REGULATION

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
17 January 2025	Change in control	Requirement for criminal background checks on controllers to apply
Early 2025	Asset management	FCA feedback on its review of private market valuations expected
Early 2025	Diversity and Inclusion	Final rules on non-financial misconduct expected to be published
Q1 2025	Consumer Duty	Review of firms' treatment of customers in vulnerable circumstances expected to be published
Q1 2025	Enforcement	FCA expected to take decision on rules on publication of enforcement investigations
Spring 2025	Financial Services	The first Financial Services Growth and Competitiveness Strategy expected to be published
1 September 2025	Failure to prevent	Failure to prevent fraud offence becomes effective
During 2025	Diversity and Inclusion	FCA and PRA policy statements on the remaining diversity and inclusion proposals expected to be published
During 2025	Asset management	Possible new FCA alternative asset management portfolio letter

ITEMS COVERED IN THIS SECTION

GOVERNMENT STRATEGY FOR UK FINANCIAL SERVICES

WHAT IS THIS? The UK government approach to UK financial services including some proposed initiatives and rule changes.

WHO DOES THIS APPLY TO? Primarily persons involved in financial services.

WHEN DOES THIS APPLY? Not yet known.

The new Labour government set out its proposed approach to UK financial services in the Chancellor of the Exchequer's Mansion House 2024 speech in November 2024. This focuses on economic growth with the Chancellor, Rachel Reeves, announcing her intention to publish, in Spring 2025, the first Financial Services Growth and Competitiveness Strategy which will focus on the following priority growth opportunities: Fintech, sustainable finance, asset management and wholesale services, insurance and reinsurance and capital markets.

Other measures announced in the speech included:

- More investment into productive assets including as a result of pensions reform with the creation of "mega-funds".
- Removal of the Certification Regime from the Senior Managers and Certification Regime.
- New growth-focused remit letters to the Financial Conduct Authority (**FCA**), Prudential Regulation Committee, Financial Policy Committee and the Payment Systems Regulator.
- Establishment of the Private Intermittent Securities and Capital Exchange System (**PISCES**) - a new regulated market for private company shares.

HM Treasury also published a Call for Evidence on the Financial Services Growth and Competitiveness Strategy announced by the Chancellor. This closed for comments on 12 December 2024.

Points discussed included making the regulatory framework easier to navigate and minimising the compliance burden for firms with questions on how regulation can support responsible and informed risk-taking. The government is also supportive of the sustainable finance agenda and proposes to set up a new Transition Finance Council with the City of London Corporation. Separately it has also published a consultation on a UK Green Taxonomy and details of the new UK regulatory regime for ESG ratings providers.

The government also included some comments on its intentions for asset management which include simplifying regulation (particularly for Alternative Investment Managers), supporting fund tokenisation, and facilitating cross border activity. The government also stated that it would encourage the UK as a leading destination for private markets activity.

FCA INITIATIVES – ROUND UP

WHAT IS THIS? A round-up of FCA initiatives including changes to the FCA rules.

WHO DOES THIS APPLY TO? Mainly FCA-authorised firms but some initiatives will be relevant to non-authorised persons.

WHEN DOES THIS APPLY? Various.

The past couple of years have seen a flurry of proposed financial services regulatory reforms including the Financial Services and Markets Act 2023 and the Edinburgh reforms as well as a stream of publications from the FCA. However, the enforced hiatus as a result of the general election saw many of the FCA's proposals put on the back burner, at least temporarily. Moreover, some of the FCA's proposals have been greeted with a lack of enthusiasm and, in some cases, particularly the proposals to publicise enforcement action, with hostility (see Publicising Enforcement Investigations). 2024 did not, therefore, go as smoothly as the FCA might have wished.

However, despite the temporary slowdown in rulemaking in the middle of the year, the FCA stepped up its engagement with firms in 2024. This included a large number of Dear CEO letters such as an interim update in respect of its supervisory priorities for alternative asset management firms (see our briefing: FCA updates its alternatives supervisory strategy | Travers Smith) and on the Consumer Duty (including one for asset managers dealing with closed products and services). A further alternative asset management portfolio letter is anticipated during 2025.

There are also signs that the FCA may be receptive to industry representations and prepared to make changes to the UK Investment Firms Prudential Regime including a possible softening of some of the remuneration rules - possibly to reflect changes made by the PRA to the bankers' bonus cap and malus and clawback rules.

We set out a selection of the FCA's other initiatives during 2024 below.

Criminal background checks on controllers

As from **17 January 2025**, firms will need to have conducted a criminal background check on any individual seeking to become a controller or beneficial owner of a UK authorised firm. This was consulted on in CP24/11: Quarterly Consultation Paper No. 44 and confirmed in Handbook Notice 125. The new requirement would apply to all new applications and notifications as from that date.

It is expected that the changes will take effect through revised versions of the relevant authorisation forms. The FCA does not appear to have made any changes to its original proposals and therefore we assume that the requirement will apply as set out in the Consultation Paper which we have summarised below.

The requirement will apply on first authorisation of the firm and on any subsequent change in control (in relation to the new individual controllers following such change). The controller will need to have undertaken the check no more than 6 months before the relevant application or notification. The FCA may request a copy of the relevant check.

Criminal records checks will only need to be undertaken against individual persons: the requirement does not apply to corporate or partnership controllers, or to their directors/partners (unless, of course, any of those individual directors/partners are controllers or beneficial owners in their own right).

The scope of "controller" for the purposes of the FCA proposal is broad. It includes:

- Controllers of firms applying to become authorised.
- Would-be controllers applying for permission for a change in control of an authorised firm.
- Persons submitting a change in control notice under the UK Money Laundering Regulations, the Payment Services Regulations 2017 or the Electronic Money Regulations 2011.
- Beneficial owners of Annex 1 financial institutions (i.e. firms which are required to be registered with the FCA for the purposes of the UK Money Laundering Regulations but are not otherwise authorised or regulated by the FCA).
- Individuals with a "qualifying holding" in a payment institution or e-money institution.
- Beneficial owners of registered cryptoasset businesses.

Importantly, the requirement to undertake a criminal record check applies to the controller or beneficial owner wherever that individual is located.

For individual controllers or beneficial owners in England and Wales, the required check will be a criminal background check from the Disclosure and Barring Service – this is expected to mean a "standard DBS check" in the majority of cases.

Other controllers or beneficial owners will have to obtain an "equivalent" check. The requirement to obtain an equivalent overseas check has been an area of concern for firms as it is not clear exactly what checks would be required and in what circumstances a requirement to carry out a check in a particular jurisdiction would be triggered. This could be an issue for jurisdictions where checks are done on a state-by-state basis or in the case of internationally mobile persons. Although not explained in any depth, the FCA stated in the Consultation Paper that it may exercise a degree of discretion in cases where an individual is not able to obtain an equivalent to a UK criminal record check. However, the FCA does not consider that seeking equivalent overseas checks would substantially burden firms.

As a general principle, requiring criminal records checks for controllers and beneficial owners of UK authorised firms seems difficult to argue against. However, the real test will be how this works in practice, particularly whether the FCA adopts a proportionate and workable approach to overseas checks and, more generally, the extent to which the requirement slows down the authorisation process.

Consumer Duty

The FCA's Consumer Duty has been a key focus for many firms over the past couple of years. This continued in 2024 with the Consumer Duty starting to apply in respect of all products and services held in "closed books" on 31 July 2024 and a number of additional guidance publications from the FCA. These included Consumer Duty implementation: good practice and areas for improvement and Price and Value Outcome: Good and Poor Practice update.

Work on implementing the Consumer Duty will continue in 2025. The FCA sees this as a continuing process and Sheldon Mills, executive director of consumers and competition at the FCA stated in July 2024: *"This is just the beginning of the journey not the end […] there is much more to come".*

It is expected that there will be further work by the FCA on how firms are implementing the Consumer Duty as well as sharing information on good practice and the FCA's expectations. The FCA has already published its multi-firm review on payments firms' implementation of the Consumer Duty. There is little doubting now the significance the Consumer Duty has assumed as regards the way that firms are expected to do business (a significance greater than many firms originally anticipated) and it provides the FCA with a new set of tools with which to hold firms' feet against the fire. It is unlikely to be long before we start seeing published enforcement actions against firms which are considered to be non-compliant.

More concretely, the FCA has already started a review of FCA requirements following the introduction of the Consumer Duty considering where other retail conduct rules can be simplified following the introduction of the Consumer Duty (although this is not a review of the Consumer Duty itself).

The FCA also set out its Consumer Duty focus areas for the remainder of 2024/25 including:

- Assessing across sectors how firms are implementing and complying with the Consumer Duty including a review of board reports, a review of firms' treatment of customers in vulnerable circumstances (which is expected in Q1 2025) and a review of how firms support their customers across the customer journey. As part of this, the FCA published reports on Consumer Duty Board Reports: good practice and areas for improvement and Complaints and root cause analysis: good practice and areas for improvement in December 2024.

- Considering the price and value outcome – the most consequential of the four outcomes – including how investment platforms and SIPP operators deal with any interest earned on customers' cash balances and the transparency of charges for unit-linked pensions and long-term savings.

- Work on specific sectors including retail banking, consumer finance, payments and digital assets and consumer investments. The FCA will also look at the Sustainability Disclosure Requirements and investment labels.

Expansion of dormant assets scheme

The FCA set out its rules for the further expansion of the Dormant Assets Scheme (**DAS**) in PS24/10: Expansion of the Dormant Assets Scheme – second phase. These brought into scope additional types of assets including those held as client money under the FCA's CASS rules and monies due to investors in authorised funds.

The DAS is a voluntary arrangement under which certain types of dormant assets held by firms can be transferred to an Authorised Reclaim Fund (**ARF**). The ARF rather than the firm then becomes responsible for meeting any claims.

In order to be able to transfer dormant assets to the ARF, a firm must meet certain conditions including that the firm has been unable to trace the relevant client. For authorised funds, information on the possibility of transferring dormant assets to the DAS must also be included in the instrument constituting the fund and the prospectus.

The new FCA rules in respect of client money and funds took effect on **2 August 2024**.

FOCUS ON PRIVATE MARKETS

WHAT IS THIS? Regulatory action focusing on private markets.

WHO DOES THIS APPLY TO? Private markets participants including private equity and venture capital firms.

WHEN DOES THIS APPLY? Various.

The government stated in HM Treasury's Call for Evidence on the Financial Services Growth and Competitiveness Strategy that it would encourage the UK as a leading destination for private markets activity. The FCA has also been engaging with private markets firms including Nikhil Rathi, the FCA Chief Executive, meeting with several private markets firms in the US in October 2024. This suggests a significant change of approach for the FCA. However, that does not mean that private markets will necessarily be subject to less regulatory scrutiny.

The FCA launched, in 2024, its review of private market valuations with selected firms requested to provide details on their approaches to valuing private market assets including granular financial information on their UK activities and details of the valuation processes used. A subset of those firms was also subject to a deeper dive. The FCA is expected to provide its feedback in early 2025.

The Prudential Regulation Authority wrote to bank CEOs in April 2024 regarding their risk management practices in respect of private equity related financing activities. Further, the Bank of England, as seen by a speech in April 2024 by Nathanaël Benjamin of the Bank of England's Financial Policy Committee, has concerns about developments in private equity which could ultimately affect financial stability particularly as a result of interconnectedness with other participants in the financial system. Particular issues highlighted included increased funding costs for highly-leveraged companies backed by private equity as a result of higher interest rates, lack of exit opportunities for (illiquid) private equity fund investments and the impact of NAV financing. This was followed by the Bank of England's Financial Stability Report in June 2024 which discussed vulnerabilities as a result of private equity including high leverage, opacity around valuations, variable risk management practices and interconnections with riskier credit markets as well as potential spill over from other international markets (particularly the US).

Outside the UK, other regulatory bodies are also considering how to deal with issues around non-bank financial intermediaries (**NBFI**) including the European Commission which has issued a consultation on the macroprudential supervisory framework for NBFI (see EU Consultation on Macroprudential Policies for NBFIs) and the Financial Stability Board (**FSB**) which identified enhancing the resilience of NBFI as a priority reform in its 2024 Annual Report.

Late in 2024, the FSB issued its Consultation report on Leverage in Non-bank Financial Intermediation with policy recommendations for supervisory authorities to monitor and address financial stability risks from leverage in NBFI. These included: public and private disclosures; activity-based measures such as minimum haircuts and enhanced margining requirements; entity-based measures such as concentration and large exposure limits and leverage limits; and adopting an approach of "same risk, same regulatory treatment" for NBFI leverage and leverage from other, similar exposures.

FCA RULES ON DIVERSITY AND INCLUSION

WHAT IS THIS? Proposed new rules on diversity and inclusion as well as non-financial misconduct.

WHO DOES THIS APPLY TO? FCA authorised firms although some rules may only apply to larger firms.

WHEN DOES THIS APPLY? Not yet known.

In September 2023, the FCA published its long-awaited consultation on diversity and inclusion (**D&I**) which we discussed at the time in our briefing: FCA consults on new Diversity and Inclusion rules | Travers Smith.

The original proposals broadly fell into two categories.

The first category, which was expressed to apply to all relevant firms regardless of the number of employees, included the incorporation of non-financial misconduct into the FCA's Conduct Rules, fit and proper assessments, suitability guidance on the Threshold Conditions and guidance on regulatory references. There would also be annual reporting on employee numbers (except for limited-scope SM&CR firms).

The second category only applied to large firms with 251 or more employees and included requirements such as developing a D&I strategy; setting targets to address underrepresentation; reporting and making public disclosures annually on certain D&I matters; and incorporating D&I into the firm's governance.

The proposals, particularly those relating to D&I targets and reporting, caused some disquiet among regulated firms and received criticism from the House of Commons Treasury Committee.

In October 2024, the FCA issued key findings on non-financial misconduct, including action points for firms, following its survey of wholesale firms. We discussed this in our briefing: **FCA findings on non-financial misconduct | Travers Smith.**

The FCA has stated that it will initially focus on the proposals relating to non-financial misconduct with final rules to be published in early 2025. FCA and PRA policy statements on the remaining diversity and inclusion proposals should follow later in 2025.

2 ESG AND SUSTAINABLE FINANCE

INTRODUCTION

ESG and the EU

In the EU, 2024 was a year of consolidation, introspection (to a degree) and some considered brainstorming as to the future. While it is perhaps true that none of this quite amounted to radical blue sky thinking, there is a readiness to embrace fundamental change where necessary, including in relation to the Sustainable Finance Disclosure Regulation, which is widely thought to have mis-fired. The **SFDR 2.0 review** is ongoing, with the European Commission expected to publish draft proposals by June 2025. The European Supervisory Authorities have issued opinions on what the Commission should be considering. The Platform on Sustainable Finance has pitched in with its recommendations. Change – possibly quite substantial change – is all but inevitable but, if and when the formal legislative process begins, will be some considerable time coming. In the meantime, the European Commission is reviewing amended SFDR regulatory technical standards setting out, among other things, changes to the PAI framework, GHG emissions reduction targets and new, amended disclosure templates (known colloquially as "**SFDR 1.5**"). This package of measures – once adopted – will likely come into effect a year from the legislation coming into force.

The European Commission's really quite impressive report on the future of European competitiveness takes a long, hard look at what the European project is up against. It sometimes makes sobering reading. Prepared by Mario Draghi, a former president of the European Central Bank, and running to nearly 400 pages over its two parts, it covers a wide range of economic issues; on those aspects of the report that specifically focus on ESG regulation see our **September 2024 Sustainability Insights briefing**. The report is clear that some reform of sustainability disclosure rules is needed, to reduce burdens on business. Partly as a response to that, but also following business lobbying and political pressure, the European Commission has announced that it will propose an "omnibus regulation" to make changes to the CSRD, the EU Taxonomy and the Corporate Sustainability Due Diligence Directive (referred to as CS3D).

ESMA's Guidelines on Fund Names – which have applied to all new funds as from 21 November 2024 – will, following the expiry of transitional relief, apply to all funds that were in existence before that date as from 21 May 2025. The finalised **EU ESG Ratings Regulation**, with a scope and application broad enough to trip up the unwary (including in the asset management industry), will likely come into effect in the second half of 2026.

For our further thoughts on EU sustainabilty regulation in the coming year and beyond, see our December 2024 briefing **Travers Smith's Sustainabilty Insights: EU sustainabilty regulation in 2025**.

ESG and the UK

As we have previously reported, by comparison the UK is also pursuing a pro-ESG strategy, committed to climate and sustainability disclosure requirements. The new UK government has not yet confirmed its approach in a number of important respects.

The FCA's ESG rules mandating **TCFD-aligned disclosure rules** are now fully in place and the UK's **Sustainability Dislcosure Regime (SDR) and associated labelling regime** is crystalising on a phased basis, for UK asset managers at least. The new investment labels became available on 31 July 2024, with their associated disclosures and, as from that date, the naming and marketing rules kicked in as regards any labelled products. More generally, those naming and marketing rules (and the associated disclosure requirements) started applying to unlabelled products on 2 December 2024. "On demand" product-level sustainability information requests will be available from 2 December 2025, on which date entity-level disclosure requirements will be in force for firms with assets under management of £50 billion or more. Finally, a year later, on 2 December 2026, entity-level disclosure requirements will be in force for small asset managers with AuMs of £5 billion or more.

The extension of the above requirements to **segregated portfolio managers** has been delayed. Originally proposed to take place, broadly, at the end of 2024, the FCA is still thinking about it (perhaps in the light of "teething problems" for asset managers who are getting to grips with the new regime) and further information about implementation is expected in Q2 2025. Proposals to further extend the regime to **funds within the Overseas Funds Regime** are also still awaited.

The UK will have its own regime regulating **ESG rating providers**, although not for some years to come, and after the EU regime is in force.

Finally, if one were asked to liken the development of the much-anticipated **UK Green Taxonomy** to a board game, Snakes and Ladders comes to mind. After considerable time spent by GTAG and others patiently climbing up ladders to the point of a promise that a detailed consultation would be published in autumn 2023, we seem to have slipped down a snake to somewhere near the start, with a high-level consultation from a new government now seeking to reassess whether we need a UK taxonomy at all and, if so, what its use cases might be.

Travers Smith resources

See our regular updates and lengthier guidance and analysis of ESG-rated developments which can be found on the **ESG and Impact section** of the Travers Smith website. From here you can find links to a number of useful resources: our latest articles, briefings and press on ESG and impact, the **Travers Smith interactive ESG tool** to help managers understand their reporting obligations under UK TCFD and EU SFDR (consisting of a **UK TCFD App** and an **EU SFDR App**) and the ESG Academy 2024, a free, online training programme led by experts in the firm and designed for clients.

To continue keeping abreast of news items and our views on them, you may be interested in reading or listening to our **Sustainability Insights**, a regular series of briefings with the latest thinking from our team of experts on sustainable finance topics for the alternative asset management industry.

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
13 January 2025	UK SDR – Anti-greenwashing rule	FCA consultation on corrections and clarificatory amendments to the Anti-greenwashing Rule and SDR closes.
6 February 2025	UK Green Taxonomy	Government consultation closes

26 February 2025	Omnibus law on sustainabilty reporting	Indicative date on which the EU's College of Commissioners will meet to discuss the omnibus simplification package. A draft of the law may be available before or after that meeting
Early 2025	UK regulation of ESG ratings providers	HM Treasury intends to lay secondary legislation
5 March 2025	UK ESOS	Latest date by which large UK undertakings (and their corporate groups) must submit their first ESOS Action Plan (although the Environment Agency was encouraging firms to submit by the original deadline of 5 December 2024)
Q2 2025	UK SDR and labelling regime – extension to portfolio management	FCA intends to publish a policy statement and further information about implementation of the extension to portfolio management
21 May 2025	ESMA Funds' Names Guidelines	Expiry of the transitional period for funds that were in existence as of 21 November 2024
Mid-2025	SFDR 2.0	Details of Commission's proposals to amend SFDR (either by way of formal proposal or some indication of direction of travel) expected
2 December 2025	UK SDR and labelling regime	'On demand' product-level sustainability information requests available. Entity-level disclosures in force for firms with assets under management of £50 billion or more
5 December 2025	UK ESOS	Date by which large UK undertakings (and their corporate groups) must submit the update to the first ESOS Action Plan
During 2025	SFDR 1.5	Regulation amending SFDR RTS in force (precise date depends on whether and when the Commission adopts the RTS and its publication in the Official Journal)
1 January 2026	California Climate Corporate Data Accountability Act and Greenhouse Gases: Climate-related Financial Risk Act	The first reporting deadline for in-scope entities (subject to relief granted by the California Air Resources Board)
2 July 2026	EU ESG Rating Activities Regulation	Date on which the Regulation applies to ESG ratings providers (subject to transitional provisions).
26 July 2026	EU Corporate Sustainabilty Due Diligence Directive	Date by which Member States must have transposed the Directive into national law.

2 August 2026	EU ESG Rating Activities Regulation	Date by which ESG rating providers which were operating in the EU on 2 December 2024 must notify ESMA if they wish to continue offering their services and will be applying for authorisation or recognition
2 November 2026	EU ESG Rating Activities Regulation	Date by which ESG rating providers which were operating in the EU on 2 December 2024 must have applied for authorisation or recognition, failing which they must cease providing services in the EU as of that date
2 November 2026	EU ESG Rating Activities Regulation	Date by which small ESG rating providers which were operating in the EU on 2 December 2024 must have notified ESMA that they wish to continue providing their services in the EU, failing which they must cease providing services in the EU as of that date
2 December 2026	UK SDR and labelling regime	Entity-level disclosures in force for firms with assets under management of less than £50 billion, but £5 billion or more
26 July 2027	EU Corporate Sustainabilty Due Diligence Directive	Compliance deadline for EU firms with more than €1.5bn worldwide turnover and 5,000 employees Compliance deadline for non-EU firms with more than €1.5bn EU turnover

ITEMS COVERED IN THIS SECTION

SFDR 1.5: AN INTERIM SET OF MEASURES ENHANCING PAIs AND DISCLOSURES PENDING SFDR 2.0

WHAT IS THIS? A set of amendments to the principal adverse impacts and financial product disclosures in the SFDR regulatory technical standards.

WHO DOES THIS APPLY TO? Financial markets participants – EU portfolio managers, investment advisers, AIFMs and UCITS management companies. Also relevant to non-EU firms marketing or distributing products in the EU.

WHEN DOES THIS APPLY? The RTS are currently subject to scrutiny. Timing remains unclear; but adoption (assuming the Commission decides to do this) will presumably occur earlier rather than later in 2025.

In our **New Year Briefing 2024**, we reported that the ESAs had issued their final report on draft regulatory technical standards (**RTS**) on principal adverse impacts and financial product disclosures. As we mentioned, some of the changes will be substantive and significant – you can read a summary of those changes here.

The draft RTS were delivered to the European Commission for scrutiny and have been with them for some time. There was some suggestion that they were due to be adopted at the end of 2024 or the beginning of 2025 with the possibility of firms having up to one year from the date on which they enter into force to start reporting on the amended and simplified reporting templates.

SFDR 2.0: ONGOING REVIEW OF THE EU SUSTAINABLE FINANCE DISCLOSURE REGULATION

WHAT IS THIS? A fundamental review of the Sustainable Finance Disclosure Regulation by the European Commission with a view to making amendments.

WHO DOES THIS APPLY TO? All industry participants but will be of particular interest to EU firms, such as investment advisers, portfolio managers and fund managers, who are required to comply with SFDR. Also relevant to non-EU firms marketing or distributing financial products in the EU.

WHEN DOES THIS APPLY? Not yet known – some indication of the Commission's proposed direction of travel may emerge in mid-2025.

The consultations – a reminder

As we covered in **last year's New Year Briefing**, in September 2023, the European Commission issued two consultations on the implementation of the Sustainable Finance Disclosure Regulation (**SFDR**) seeking views on the practical functioning of the Regulation and ideas for reform.

The first consultation was a Targeted Consultation, aimed at stakeholders who are more familiar with the SFDR and the EU's sustainable finance framework, and the second was a Public Consultation, aimed at a broader range of stakeholders and including a sub-set of the questions in the Targeted Consultation.

The consultations followed recognition by the European Commission that firms have been facing significant challenges in complying with the SFDR and, in particular, that it has been less user-friendly than expected.

No specific proposals were included in the consultations but the questions asked provided some indication of the EU's thinking and the key areas where reform is being considered. Key areas discussed included:

- A potential categorisation system for financial products – potentially either based on the current Articles 8 and 9 of the SFDR or on brand new categories.
- The possibility of product level disclosure requirements for all financial products offered in the EU, including those which do not make any sustainability related claims (e.g., so-called "Article 6 products").
- A reworking of the SFDR **disclosure** requirements.

We discussed the consultations and their possible implications in our September 2023 briefing: **Possible changes to the EU SFDR? The European Commission seeks views | Travers Smith.**

The feedback

In May 2024, the European Commission published a Summary Report summarising the responses it had received to its September 2023 consultations. While the report was "neutral" – in that it did not provide evidence of the Commission's views or suggest a likely direction of travel – it did provide some insight into how the industry is (or at least *was* at the time) thinking. We discussed the key messages arising from the Summary Report in our May 2024 briefing: **EU SFDR review: Summary of industry views | Travers Smith**

When are we likely to see something from the European Commission?

The Commission is now in receipt of the feedback to its September 2023 consultations, two opinions from the Joint Committee of the ESAs and ESMA respectively, ESMA's recommendations on PAI disclosures and the Platform on Sustainable Finance's recommendations on the shape and content of a product categorisation regime (see below). It is not clear when a legislative overhaul will begin in earnest with a formal Commission proposal. In its latest updated implementation timeline for SFDR (and other EU measures), ESMA has tentatively suggested that we may see some materials on the SFDR 2.0 review in **"mid-2025"**, although both it and the other ESAs strongly recommended that the Commission conducts its own consumer testing first.

It is also too early to predict with certainty where the Commission will land on various issues. But given the focus of discussion over the last couple of years or so (including most recently in the opinions of the ESAs and ESMA and the Platform's categorisation proposals) it would be highly surprising if the Commission ignored the weight of broadly aligned opinion. So we can be relatively confident in anticipating at least: the introduction of some kind of product categorisation or labelling regime (with two or three categories, most likely for "sustainable" and "transition" funds) to replace the Article 6, 8 and 9 distinctions; the simplification of a regime that has become overly complex; and the smoothing out of inconsistencies between the disclosure regime and the EU Taxonomy. A great deal of detail will underlie that. Unfortunately, it is probably safe to say that, whilst it is likely that there will be some similarities between the UK and EU regime, it is also likely that there will be very considerable differences.

The Opinions and the recommendations of the Platform on Sustainable Finance

In June 2024, the European Supervisory Authorities (**ESAs**) had published a Joint Opinion on the assessment of the SFDR. The Opinion was addressed to the European Commission, with a copy sent to each of the European Parliament and the Council.

In the Opinion, the ESAs addressed a number of things that had become discussion points in the industry over the previous months, including the introduction of new product categories to replace the *de facto* labelling of Article 8 and Article 9 products, the introduction of new "sustainability indicators" using letters and/or colours, similar to other consumer-friendly rating methods used in financial services and other sectors, the simplification of disclosures and the clarification of the relationship between SFDR sustainable investments and investments in Taxonomy-aligned activities.

Just over a month after the publication of the ESAs' Opinion, one of those supervisory authorities, ESMA, published its own "solo" Opinion entitled: Sustainable investments: Facilitating the investor journey – a holistic vision for the long term. In drafting its own Opinion, ESMA took into account the Joint ESAs' Opinion of the SFDR, published just weeks beforehand, with which it was, it said, "broadly aligned". Given that ESMA was one of the authors of that Joint Opinion, it would have been surprising and worrying had it not been so aligned.

On 17 December 2024, the influential Platform on Sustainable Finance (**Platform**) pitched in with its contribution to the SFDR 2.0 review debate by way of a set of recommendations as to what a product categorisation regime should look like: Categorisation of Products under the SFDR: Proposal of the Platform on Sustainable Finance.

In outline, the Platform – in similar, but not identical, fashion to the ESAs – recommends the introduction of a product categorisation regime within SFDR, essentially "labels" attaching to products with three sustainability strategies, each of which will be subject to minimum criteria (e.g. in terms of a minimum percentage, defined objectives and measurable KPIs). These categorisations would replace the current Article 6, 8 and 9 distinctions:

- **Sustainable**: this would be for products with Taxonomy-aligned investments or (where the Taxonomy does not apply) Sustainable Investments, that do no significant harm (alternatively this could be narrowed to assets specifically based on a "more concise definition" consistent with the EU Taxonomy).

- **Transition**: this would be for those investments or portfolios that are transitioning in accordance with the European Commission's 2023 Recommendation on facilitating finance for the transition to a sustainable economy, measured with credible transition pathways or plans on portfolio and/or investment level.

- **ESG collection**: this somewhat inelegant and not-entirely-intuitive description would apply to products that exclude significantly harmful investments/activities and which invest in assets with better environmental and/or social criteria or apply various sustainability factors. The minimum criteria here would require that a specified percentage of the product's assets follow one or a combination of one or more material sustainability feature(s).

Each of the categorised products would be subject to specific pre-contractual disclosure and reporting requirements. Interestingly, the Platform floats the idea of categorisation going beyond the scope of SFDR to include products and services under the sustainability preferences requirements to which firms are subject under MiFID and the Insurance Distribution Directive.

Although the Platform does not go quite so far as to recommend a fourth categorisation or an explicit sub-category at this stage, it does suggest that the European Commission should develop a common understanding on impact investing in the context of the EU sustainable finance framework and how it relates to the EU Taxonomy, with a view to integrating such investing into the categorisation scheme.

All other products which fail to meet the requisite criteria for any of the above categorisations – or which have not been categorised by the financial market participant (whether by choice or at the instance of the investor) – would be identified as "unclassified products". Unclassified products would not be subject to minimum criteria. Where such products nonetheless have sustainability features and the FMP chooses, or is required, to disclose these, the pre-contractual disclosure must include a description of the relevant features. Unclassified products would in all cases be subject to some specific reporting requirements (e.g. percentage of Taxonomy-alignment (Revenue and CapEx) and selected PAIs (such as PAI GHG emissions).

The Platform also recommends a revision of the SFDR definition of "sustainable investment", while broadly retaining the existing structure.

The PAI annual report

On 30 October 2024, the ESAs published their third Annual Report to the Commission on Principal Adverse Impact disclosures under the Sustainable Finance Disclosure Regulation. As with the two previous annual reports, the latest report did not change the law, but various narrative comments did serve to indicate the supervisors' current expectations on voluntary disclosures of PAIs. Furthermore, the ESAs make a point in their recommendations of specifically suggesting that the Commission may want to consider the findings of the report and take them into account as part of its ongoing SFDR 2.0 review.

The Annual Report sets out the background to the ESAs' review, their analysis of PAI statements and PAI indicators (entity level and financial product level), "good" and "bad" practices and lessons learned from their observation of NCA data collected (mostly from public funds) and a set of recommendations to the European Commission and to the NCAs.

In keeping with the two previous reports, the 2024 survey carried out by the ESAs covered both the assessment of disclosures made by financial market participants choosing to explain why they do not consider PAIs, as well as disclosures of PAI considerations for financial products.

In terms of next steps, and as they had already mentioned in their Joint Opinion on the assessment of the SFDR (see above), the ESAs believe that the frequency of their reports should be reduced to once every two to three years, to enable them to devote more resources to delivering a "more meaningful analysis" of PAI disclosures.

ESMA GUIDELINES ON FUND NAMES

WHAT IS THIS? ESMA guidelines on the use of ESG or sustainability-related terms in funds' names.

WHO DOES THIS APPLY TO? AIFMs, internally-managed AIFs and UCITS management companies; managers of EuVECAs, EuSEFs, ELTIFs and money market funds.

WHEN DOES THIS APPLY? New funds: 21 November 2024; funds existing before 21 November 2024: 21 May 2025.

They were a long time coming, but eventually, on 14 May 2024, ESMA published its final Guidelines on funds' names using ESG or sustainability-related terms (ESMA had first consulted on these back in November 2022, followed by a report, without policy recommendations, in October 2023). We covered the final Guidelines in our May 2024 briefing: **ESMA Guidelines on Fund Names | Travers Smith**

The Guidelines were published in all EU official languages on 21 August 2024, and started applying three months later, on **21 November 2024** to all newly created funds (i.e. funds created on or after that date).

However, a transitional period for those funds which existed prior to 21 November 2024 applies – they have until **21 May 2025** to comply, either by bringing their funds in line with the Guidelines or by changing the name of their fund(s) so as not to include the offending term(s).

National competent authorities had until 21 October 2024 to notify ESMA whether they (i) comply, (ii) do not comply, but intend to comply, or (iii) do not comply and do not intend to comply with the guidelines. All national regulators are applying the Guidelines in full: this includes closed ended funds that are not open to new investors, scotching hopes in the industry that some competent authorities at least might adopt a pragmatic view. In particular, on 21 October 2024, the Central Bank of Ireland (**CBI**) published a Notice of its intention in relation to the Guidelines on funds' names using ESG or sustainability-related terms in which it said that it will, in due course, consult on the incorporation of related provisions in the Central Bank UCITS Regulations and AIF Rulebook, but that, in the interim, it expects full compliance with the Guidelines from 21 November 2024. On the same date, the *Commission de Surveillance du Secteur Financier* (**CSSF**) published a communiqué in which it confirmed that it would be complying with the Guidelines in full – see Luxembourg round-up.

On Friday 13 December 2024, ESMA published three further Q&As on the application of the Guidelines on Fund Names:

- *"Meaningfully invest in sustainable investments" (ESMA_QA_2373)*: under the Guidelines, funds using "sustainable" terms must commit to invest "meaningfully" in sustainable investments. The additional Q&A clarifies that, while national competent authorities should carry out a case-by-case analysis of how any sustainability-related term is used in the name of the fund, they "may find that investment funds that invest less than 50% of the proportion of investments in sustainable investments are not "meaningfully investing" as required. The circumstances of each case may mean that that percentage could be higher.

- Paris-aligned Benchmarks/Climate Transition Benchmark exclusions: European Green Bonds (ESMA_QA_2368): in-scope fund investments must be assessed against the exclusions of investments referred to in paragraphs 16-18 of the Guidelines (the Paris-aligned Benchmarks (PAB) and the Climate Transition Benchmarks (CTB)). The additional Q&A clarifies that investments in European Green Bonds are not subject to this because they are already subject to existing standards under the European Green Bonds Regulation. However, other green bonds and use of proceeds instruments *not* issued under the European Green Bonds Regulation should be assessed against the exclusions on a look through basis –

i.e. the exclusions should be measured at the level of the economic activities financed by such instruments.

- Paris-aligned Benchmarks/Climate Transition Benchmark exclusions: controversial weapons (ESMA_QA_2371): the Delegated Regulation setting out minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks specifies what companies must be excluded from such benchmarks. This includes companies investing in controversial weapons, but by reference to a definition of "controversial weapons" as meaning "as referred to in international treaties and conventions, United Nations principles and, where applicable, national legislation". The additional Q&A clarifies that national authorities may, in the absence of further clarification in the Delegated Regulation, refer to the list of controversial weapons set out in principal adverse indicator 14 of Table 1 of Annex 1, EU SFDR: i.e.: "anti-personnel mines, cluster munitions, chemical weapons and biological weapons".

EU REGULATION OF ESG RATINGS PROVIDERS

WHAT IS THIS? EU Regulation on the transparency and integrity of ESG rating activities.

WHO DOES THIS APPLY TO? ESG rating providers "operating in the EU" which issue and publish or distribute ESG ratings, and financial market participants or financial advisers which disclose ESG ratings a part of their marketing communications.

WHEN DOES THIS APPLY? 2 July 2026.

On 12 December 2024, the EU Regulation on ESG rating activities (Regulation (EU) 2024/3005) was published in the Official Journal. The Regulation entered into force on 2 January 2025 and will apply from **2 July 2026** (18 months from entry into force). There are some transitional provisions for those firms providing services as of 2 January 2025 (see below).

The Regulation should be compared and contrasted with the UK's own proposals for the regulation of ESG providers (see **UK regulation of ESG Ratings Providers** below). It will be seen that some of the thinking is the same or similar (based on the IOSCO Final Report on ESG Ratings and Data Product Providers (November 2021)) but there are inevitably differences in approach and the UK position has not yet set out the level of detail contained in the EU's proposal.

Outline

Broadly, the Regulation:

- specifies that ESG rating providers (as defined) must, where they are based in the EU, be authorised by ESMA and subject to its ongoing supervision; and

- imposes requirements on ESG rating providers relating to their internal organisation, disclosures concerning methodologies and mechanisms intended to address conflicts of interest.

Definitions

An ESG rating is an opinion or score (or combination of the two) regarding an entity, a financial instrument, a financial product, or an undertaking's ESG profile or characteristics or exposure to ESG risks or the impact on people, society and the environment, that is based on an established methodology and defined ranking system of rating categories and that is provided to third parties, irrespective of whether such ESG rating is explicitly labelled as "rating" or "ESG score".

An ESG rating provider is a legal person whose occupation includes the offering and distribution of ESG rating or scores on a professional basis.

Scope: what the Regulation will apply to

Firms must exercise caution with regards to the scope of the Regulation because it is capable of catching things beyond what one would naturally think of as an "ESG rating".

The Regulation will apply in relation to *ESG ratings* issued by *ESG rating providers* operating in the EU that are disclosed publicly or that are distributed to regulated financial undertakings in the EU, undertakings that fall within the scope of the EU Accounting Directive or EU-wide public authorities or those in EU Member States. As you would expect, "regulated financial undertaking in the EU" has wide meaning: it includes credit institutions, investment firms, AIFMs and AIFs, UCITS and UCTIS management companies, insurance and reinsurance companies, IORPs, CCPs, CSDs, payment and electronic money institutions, crypto-asset service providers and securitisation special purpose entities. Firms using proprietary scoring systems may be in scope if they make reference to such scores in their marketing materials. However, a recital indicates that the sole distribution of ESG information on entities or financial products relying on proprietary or established methodology (including datasets on emissions and on "ESG controversies") are not in scope.

UK firms and others from outside the EU should not assume that the Regulation will not catch them: it has extraterritorial scope. This is because "operating in the EU" means either:

- ESG rating providers *established in the EU*, when they issue and publish their ESG ratings on their website or through other means or when they issue and distribute their ESG ratings by subscription or other contractual relationships (**EU ESG rating providers**); or

- ESG rating providers *established outside the EU*, when they issue and distribute their ratings by subscription or other contractual relationships to regulated financial undertakings in the EU (**Third-country ESG rating providers**).

The definitions are important here. An "ESG rating provider" is a legal person whose occupation includes the issuance and offering or distribution of ESG ratings or scores on a professional basis (distribution can be via subscription or "other contractual relationship").

An "ESG rating" is an opinion or score (or combination of both) that relates to the ESG profile or characteristics of a rated item (i.e. a legal person, a financial instrument or a financial product) and which is based on an established methodology and a defined ranking system of rating categories. It is a question of substance; it is irrelevant what the ESG rating is actually called.

However, significantly the Regulation will also partly apply (by way of an amendment to EU SFDR) to persons other than ESG ratings providers: financial market participants or financial advisers will also be caught where they disclose an ESG rating (as defined) to third parties as part of their "marketing communications". Again, non-EU entities are within scope. Because the term "ESG rating" is broadly defined – essentially it just requires some kind of methodology and ranking system – firms should take care to avoid being caught by the Regulation inadvertently when marketing.

Disclosures required by regulation (e.g. SFDR pre-contractual, website and periodic disclosures) do not amount to marketing communications (see the other exemptions below) but other communications may do. Furthermore, the scope of the final regulation is narrower than had previously been understood in that the act of simply repeating a third party score (and not issuing it) is not within scope in the final text (an earlier draft had implied that it was). However, all firms should carefully review their marketing materials to determine whether they use ESG ratings and whether they may be caught.

Scope: what the Regulation will not apply to

There are some express exemptions, including:

- Private ESG ratings not intended for public disclosure/distribution.
- ESG ratings produced by EU regulated financial undertakings (e.g. AIFMs, investment firms etc) that are exclusively for internal use or for providing in-house or intragroup financial services and products.
- ESG ratings that are issued by regulated financial undertakings incorporated *in the EU* in a product or service that is already regulated under EU law (e.g. under EU SFDR, EU MiFID, EU AIFMD, EU UCITS, CRD IV etc) and which are disclosed to a third party, provided that where such disclosure is part of the financial undertaking's marketing communications, it must nonetheless include on its website prescribed disclosures with a link to those disclosures in the marketing communication.
- Mandatory disclosures required by Articles 6, 8, 9, 10, 11 and 13 of EU SFDR and by Article 5, 6 and 8 of the EU Taxonomy Regulation – therefore, ESG ratings referenced only in SFDR pre-contractual, website and periodical disclosures will not be caught by the Regulation.
- Products or services that incorporate an element of an ESG rating, including MiFID investment research.
- The provision of "raw" ESG data that do not contain an element of rating or scoring and which are not subject to any modelling or analysis resulting in the development of an ESG rating.
- Credit ratings issued under the Credit Ratings Agency Regulation.

Authorisation of EU ESG rating providers

Any legal person established in the EU wishing to provide ESG ratings in the EU will require authorisation by ESMA and will appear on a register maintained by ESMA. Transitional arrangements will apply to providers operating in the EU at the time the Regulation enters into force (see below).

Small EU ESG ratings providers (small undertakings or small groups as defined by reference to the Accounting Directive) are subject to a temporary regime and, once registered by ESMA, will only have to comply with certain provisions of the Regulation. Alternatively, such providers may opt in to full compliance with the Regulation.

The temporary regime is available for three years from registration (or until such time as the small EU ESG rating provider ceases to be categorised as a small EU ESG rating provider, whichever is sooner). After that time, the small ESG rating provider becomes subject to all the provisions of the Regulation and must apply for authorisation within six months.

Third country ESG rating providers

Any third country ESG rating provider wishing to provide ESG ratings in the EU will only be able to do so in one of three ways:

- *Endorsement*: if the third-country ESG rating provider is in the same group as an authorised EU ESG rating provider, the latter may endorse the former's ratings provided that certain conditions are fulfilled (which broadly involve obligations on the EU ESG rating provider).

- *Recognition*: a small ESG rating provider based in a third country for which there is no equivalence decision (see below) may provide ESG ratings to regulated EU financial undertakings, but only where the annual net turnover on all of its activities is below €10 million for three consecutive years.

- *Equivalence*: an equivalence decision in relation to the third country is in place (together with cooperation arrangements between ESMA and the relevant third country authorities), the rating provider is authorised or registered to act as a rating provider in that third country, and the rating provider appears on ESMA's register. At this stage it is too early to say when (or if) the UK will be adjudged as equivalent for these purposes, although it is probably fair to say that, even if equivalence is ultimately likely, it is unlikely to happen any time soon. First, the UK legislation under which ratings providers will be regulated is lagging some way behind the EU Regulation (see below) – the existence of specific authorisation or registration as a rating provider is one of the pre-conditions (and, as the UK legislation is currently drafted, firms that are providing their ratings as part of a regulated activity for which they already have permission (e.g. as part of their management activities) will not need additional ESG rating permission). Second, as we know from experience, reaching an equivalence decision in the EU is a time-consuming process. Other third country jurisdictions (such as the US) may also find that equivalence is a long time coming.

Organisational requirements, processes and documents concerning governance

The Regulation contains provisions requiring the ESG rating provider to comply with a number of general principles (relating to e.g. independence, adequate and effective systems, resources and procedures, implementation of internal due diligence procedures to ensure that ratings are based on a thorough analysis of all relevant available information, sound administrative and accounting arrangements, use of ESG ratings that are rigorous, systematic, objective and capable of validation etc).

Separation of business and activities

In addition, ESG rating providers will be prohibited from carrying on a number of proscribed activities including, e.g., consulting activities, the issuance and distribution of credit ratings, the provision of benchmarks, investment services and activities, audit activities and banking, insurance or reinsurance activities. Where they carry on non-proscribed activities in addition to their provision of ratings, the provider must nonetheless ensure that this does not create risks of conflicts of interest.

There is a derogation: ESG rating providers will be permitted to carry out investment services and activities and auditing activities within the same legal entity provided there is a clear separation between the activities, measures to combat conflicts of interest are put in place and any person who is directly involved in the assessment process for a rating does not get involved in the investment services/activities or the auditing activities.

Aside from that derogation, an ESG rating provider may also lodge a request with ESMA to be authorised to provide benchmarks, provided it puts in place specific measures (including those outlined above). It is not a foregone conclusion that ESMA will grant any such request: it will refuse if it thinks that the measures adopted by the ESG rating provider are not sufficient to avoid potential conflicts of interest.

Individuals

ESG rating providers will be required to ensure that their rating analysts, employees and other individuals who work for them and are directly involved in the provision of ESG ratings are appropriately trained and have the necessary knowledge and experience. Among other restrictions, they are also banned from:

- Participating in fee negotiations with a rated entity (or controller of the rated entity).
- Directly buying or selling any financial instrument issued by a rated entity (holdings in diversified collective investment schemes and investments made under a discretionary portfolio management arrangement are permitted).
- Taking up a senior management position within a rated entity which they have been involved in rating for nine months after the rating is provided.

There are also restrictions – some of them overlapping with the above – on senior managers of the ESG rating provider.

Records, complaints-handling and outsourcing

ESG rating providers will be required to record their activities – Annexes I and II prescribe certain information. The records must be kept for at least 5 years. A provider must have complaint-handling procedures which should be published on its website. Outsourcing is not permitted where it would materially impair the quality of the provider's internal control policies or the ability of ESMA to supervise the provider's compliance with the Regulation.

Transparency requirements

ESG rating providers will be required to disclose on their website the methodologies, models and key rating assumptions they use (and ESMA will be drafting a regulatory technical standard (RTS) in this regard). In addition, there are specific disclosures that must be made to the rated entities themselves and to the users of ratings.

Independence and conflicts of interest

ESG providers must:

- Establish a clear organisational structure.

- Establish and operate policies, procedures and effective organisational arrangements for the identification, disclosure, prevention, management and mitigation of conflicts of interest.

- Take steps to manage the conflicts of interest that may arise.

Transitional provisions

Those ESG rating providers which operated in the EU on the date on which the Regulation entered into force (i.e. 2 January 2025) and which wish to continue offering their services and apply for authorisation or recognition will have to notify ESMA of that intention by 2 August 2026. If they make such notification, they will then have to apply for authorisation or recognition by 2 November 2026 at the latest (i.e. within four months of the date on which the Regulation applies, and within three months from the latest date on which they are required to notify ESMA). If they fail to make an application within that period, they must cease providing services in the EU altogether.

The above is modified – but not much it seems – for small ESG rating providers (i.e. small undertakings or small groups as defined by the Accounting Directive) – which operated in the EU on 2 January 2025. They will have until 2 November 2026 to notify ESMA that they wish to continue providing their services in the EU, failing which they must cease providing services.

There is no transitional relief for other providers, including any that provide new services at any time after 2 January 2025, even those new services start being provided before the application date of 2 July 2026.

CORPORATE SUSTAINABILITY REPORTING DIRECTIVE: UPDATE

WHAT IS THIS? An update on the Corporate Sustainability Reporting Directive.

WHO DOES THIS APPLY TO? All large EU companies (whether listed or not); all EU and non-EU companies listed on EU regulated markets (with some exceptions for the smallest listed companies); non-EU companies with both substantial operations (measured by turnover derived from the EU) and some establishment in the EU (either in the form of legal entity or a branch).

WHEN DOES THIS APPLY? Member States were required to transpose the Directive into national law by 6 July 2024 (a deadline missed by many). There is phased implementation of the reporting requirements for in-scope companies depending on the size and listed status of the company.

By way of reminder, the Corporate Sustainability Reporting Directive (EU) 2022/2464 (**EU CSRD**) amends several pieces of EU legislation – primarily the EU Accounting Directive 2013/34/EU but also the EU Transparency Directive 2004/109/EC - and largely replaces the Non-Financial Reporting Directive 2014/95/EU (**NFRD**).

Scope

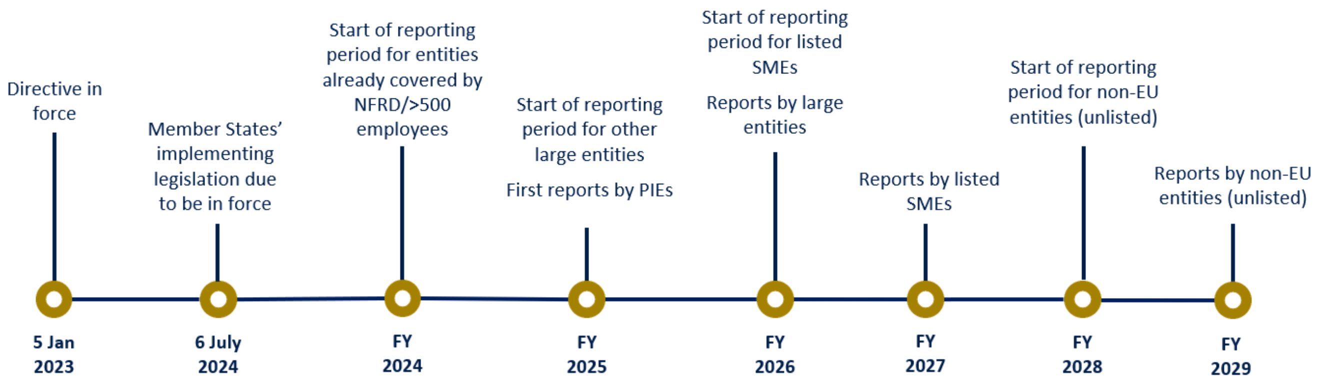
Subject to any changes made by the "omnibus" regulation (see below), EU CSRD applies to the following EU and non-EU companies:

EU/ EEA companies where:	Non-EU companies where:
They are "large" on an individual or consolidated basis – i.e. meet at least two of the following tests: €25m balance sheet, €50m turnover, 250 employees	They have over €150m turnover in the EU in the last two financial years AND have either (i) an EU subsidiary which itself is in the scope of EU CSRD, or (ii) a branch which itself has more than €40m turnover
They have securities admitted to trading on an EU regulated market – all sizes save micro	They have securities admitted to trading on an EU regulated market – all sizes save micro

Transposition and Implementation

EU CSRD was published in the Official Journal on 16 January 2022 and entered into force on 5 January 2023. Member States were required to transpose the provisions of the Directive into their national laws by **6 July 2024**. The majority of Member States missed that deadline – see our August 2024 briefing. In September 2024, the European Commission adopted a package of infringement decisions against Member States failing to transpose a number of EU Directives into national law by the prescribed deadlines. This included infringement procedures against 17 Member States for failing to implement CSRD; letters of formal notice were sent to the relevant Member States which had two months to respond. Since then, there has been some progress, but a number of Member States have still not yet completed national legislation to transpose the provisions of CSRD and bring it into force, leaving uncertainty for companies needing to publish their first report in 2025. And, of those Member States that have met the deadline, they are implementing certain aspects inconsistently with one another, which is having a potentially significant impact on firms' scoping analyses.

There is staggered implementation of the reporting requirements, pulling in the largest EU entities and groups first, followed by smaller entities listed on EU regulated markets and eventually applying to non-EU companies with significant operations in the EU as follows:



European Commission FAQs

On 13 November 2024, the European Commission published a Notice setting out frequently asked questions and responses on the implementation of the EU corporate sustainability reporting rules. This included application charts (by way of a flow chart and a table illustrating the timeline for the application of the sustainability reporting requirements for the different types/sizes of undertakings) and FAQs on scope, on the assurance of sustainability reporting, on requirements for third-country undertakings and on the interrelationship with SFDR.

On this last point, the relevant FAQ confirms that financial market participants can assume that any indicator reported as non-material by an investee undertaking subject to CSRD does not contribute to the corresponding indicator of principal adverse impacts for the purposes of SFDR disclosures – in other words, that any indicator reported as non-material by an investee company applying the European Sustainability Reporting Standards (ESRS) in accordance with the CSRD does not need to be included in the numerator of the corresponding SFDR principal adverse impact indicator.

While the Commission Notice provides some useful guidance on the implementation of CSRD (such as via giving some limited examples as to when exemptions from consolidation for financial reporting and sustainability reporting may align), it also contains some views which have been questioned and, in some cases, are set to be challenged by the market. For example, the view set out in FAQ 41 (Section IV) that: "[*t]he legal form of the ultimate third-country parent undertaking is irrelevant for the purposes of Article 40a of the Accounting Directive*" has been challenged by industry bodies on the basis that it is not reflected in (rather it contradicts) what is stated in the legislation. As such, when considering the application of the CSRD and the views set out in the Commission Notice it should be remembered that the notice is not binding and it may not extend rights and obligations nor introduce additional requirements under the legislation.

Non-EU Reporting Standards (NESRS)

The Commission's advisory body, EFRAG (the European Financial Reporting Advisory Group), is now working on a set of European Sustainability Reporting Standards for non-EU entities which may be required to report for financial years on or after 1 January 2028 where they have €150m of EU-derived turnover and an EU subsidiary in scope, or a large branch. These "NESRS" cover the same topics as the EU ESRS but only from the perspective of the impacts that the reporting business has on people and the environment. While this might help some reporting non-EU companies, others with a number of EU subsidiaries in scope will need to balance this against the benefits of preparing a group-level report that those subsidiaries may point to for their own compliance purposes.

Look out for our upcoming briefing which we are planning to publish later this month which will discuss the key considerations and potential pain points for companies facing sustainability reporting requirements this year.

Digital Tagging

EFRAG has been tasked with the development of a digital taxonomy for disclosures under Article 8 of the Taxonomy Regulation (Regulation 2020/852) ("**Art 8 DT**") and a separate digital taxonomy for the ESRS ("**ESRS DT**"). The Art 8 DT and ESRS DT were both handed over from EFRAG to the Commission and ESMA in August 2024 with the rules for tagging reported data due to be implemented via a delegated act(s) amending Commission Delegated Regulation (EU) 2019/815 on the European Single Electronic Format (**ESEF**). Guidance and standards for tagging will be incorporated by ESMA into its Regulatory Technical Standards (RTS) on ESEF. The ESEF is the electronic reporting format currently used by issuers whose securities are listed on EU regulated markets when preparing their annual financial reports. ESMA develops the RTS which specify this electronic reporting format as well as guidance and implementing tools.

For recap of developments in EU sustainability reporting in 2024, see our **briefing**.

CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE: UPDATE

WHAT IS THIS? An update on the EU Corporate Sustainability Reporting Directive – which will broadly require all in scope businesses to identify, assess and act against environmental and human rights adverse impacts connected with their operations, together with those of their subsidiaries and their broader "chain of activities".

WHO DOES THIS APPLY TO? In outline, both EU and non-EU businesses (with EU turnover) above certain thresholds may be caught (the size thresholds are considerably higher than those for CSRD).

WHEN DOES THIS APPLY? Application will be on a staggered basis, starting from 26 July 2027 for the largest in-scope companies, with all in-scope companies being required to comply by 26 July 2029.

On 5 July 2024, the Corporate Sustainability Due Diligence Directive (Directive (EU) 2024/1760) (**CS3D**) was published in the Official Journal and entered into force on 25 July 2024. Member States have until **26 July 2026** to transpose it into national law. Relative to CSRD, only a small number of the largest EU companies will be caught (see *Scope* below) – but the implications for those that are caught could be much more significant than those under CSRD, as they extend considerably beyond disclosure requirements. The requirements will be phased in, starting with the very largest companies in 2027, a second tranche of slightly smaller companies in 2028, and with the remainder of in-scope companies being required to comply by 2029 (see simplified timeline below).

Scope

EU CS3D will broadly apply to:

EU companies where:	Non-EU companies where:
They are "large" with more than 1,000 employees and a net worldwide turnover of more than €450 million	They have a net turnover in the EU of more than €450 million (no employee threshold)
The company itself is below one or both of the above threshold(s) but is the ultimate parent company* of a group which, on a consolidated basis, does have more than 1,000 employees and a net worldwide turnover of €450 million	The company itself is below the above threshold, but is the ultimate parent company* of a group, which on a consolidated basis, is above the threshold – i.e. a net turnover in the EU of more than €450 million

* Where an ultimate parent company meets the thresholds above, but is a holding company which does not engage in any management, operational or financial decisions affecting the group or any of its subsidiaries, a conditional exemption is available and it may pass the CS3D compliance obligation down to one of its EU subsidiaries, although the ultimate parent company retains joint liability for any failure of the obligated EU subsidiary to discharge its obligations

CS3D also includes lower financial thresholds for companies involved in licensing and franchising arrangements in the EU with third parties in return for royalties, but generally these will have limited application in the financial services sector. Accordingly, those thresholds are omitted from the above table.

Timeline

CS3D will apply on a phased basis, with the very largest of in-scope companies being required to comply by 26 July 2027. The timeline below is simplified:

What CS3D will mean for in-scope companies

For details on CS3D and what it will mean for those EU and non-EU companies that will be in scope – and, in particular, the application to regulated financial undertakings – see our August 2024 briefing (which was first published in Butterworths Journal of International Banking and Financial Law): **The Corporate Sustainability Due Diligence Directive: impact on financial services businesses | Travers Smith**

We also took a look at what impact CS3D – and other EU measures, including the recently finalised Forced Labour Products Regulation – will have on how companies need to understand and control their supply chains in our July 2024 briefing: **Beyond Supply Chains: new EU rules increase pressure on companies to adopt responsible business practices | Travers Smith**

OMNIBUS: POTENTIAL REVISION TO EU SUSTAINABILTY REPORTING LEGISLATION IN 2025

WHAT IS THIS? A Commission review of the overlap between the CSRD, CS3D and the Taxonomy Regulation with a view to amending their provisions in an "omnibus" regulation.

WHO DOES THIS APPLY TO? All those firms and businesses subject to the application of each of those pieces of legislation. Alleviation of the reporting burdens is likely to be focused on smaller companies.

WHEN DOES THIS APPLY? Timing is uncertain. The "omnibus simplification package" is to be discussed at the College of Commissioner's meeting on 26 February 2025. A draft of the new "omnibus" regulation may be published or be circulated around that time, although it is not yet clear.

The European Commission announced in November 2024 that it intends to review the overlap between the CSRD, the CS3D and the EU Taxonomy Regulation in early 2025.

These changes are expected to be contained in an "omnibus" law, a single piece of legislation amending the separate regulations. Very few details are available at this stage. However, the proposal responds to the Commission's commitment to make concrete proposals to reduce reporting burdens on companies by 25% in the first half of 2025.

On 4 December 2024, the European Commission published an indicative agenda of possible items for discussion at College of Commissioners' meetings from 11 December 2024 to 5 March 2025. This indicates that the "omnibus simplification package" is slated to be discussed at the meeting on 26 February 2024 (we take this to mean the omnibus law referred to above). There is talk of a draft of the legislation being available (formally or otherwise) at some point in February 2025 – this may be seen before the College discussion, or emerge as a result of that meeting.

EU SUSTAINABILTY REGIME – A ROUND-UP OF OTHER ITEMS

WHAT IS THIS? A round-up of other developments in relation to the EU sustainability regime which will have an impact going forward.

WHO DOES THIS APPLY TO? Since this is a round-up, the precise application of individual measures varies. Most provisions apply to EU portfolio managers, investment advisers, AIFMs and UCITS management companies. However, some provisions also apply to non-EU firms marketing or distributing financial products in the EU and/or certain large or listed companies. See below for further details.

WHEN DOES THIS APPLY? Various. See below for further details, where relevant

In addition to the above items, the following are worthy of note in relation to ESG and sustainable finance in the EU.

Developments with the EU Taxonomy: new FAQs

On **8 November 2024**: Commission Notice (C/2024/6691) on the interpretation and implementation of certain legal provisions of the EU Disclosures Delegated Act under Article 8 of the EU Taxonomy Regulation **on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets** (**third Commission Notice**). Previous guidance on these issues has focused on non-financial undertakings; this provides further guidance specifically in relation to financial undertakings by way of FAQs on the reporting of KPIs under the EU Disclosures Delegated Act. The draft of this was published back in December 2023.

On **29 November 2024**, the European Commission published a draft Commission Notice on the interpretation and implementation of the EU Taxonomy Environmental Delegated Act, the EU Taxonomy Climate Delegated Acts and the EU Taxonomy Disclosures Delegated Act. As with previous interpretation and implementation documents this is in the form of FAQs.

The draft was approved in principle by the European Commission on 29 November and its formal adoption in all the official languages of the EU will take place "later on", as soon as the language versions are available. Previous draft Commission Notices have taken some considerable time to be finalised – for instance, see above on the OJ publication on 8 November 2024 of Commission Notice (C/2024/6691) on the interpretation and implementation of certain legal provisions of the EU Disclosures Delegated Act under Article 8 of the EU Taxonomy Regulation on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets (third Commission Notice) – the draft of this was published nearly a year before, in December 2023.

The draft Notice contains technical clarifications responding to FAQs on the technical screening criteria set out in the Taxonomy Climate Delegated Act (including the amendments to the Taxonomy Climate Delegated Act) and the Taxonomy Environmental Delegated Act, together with the disclosure obligations for the non-climate environmental objectives laid down in the amendments to the Taxonomy Disclosures Delegated Act.

Among other things, the FAQs cover the DNSH principle, interoperability with ESRS and the frequency of third-party verification. The FAQs are split into separate sections addressing each of the objectives (climate change mitigation, climate change adaptation, water and marine resources, transition to a circular economy, pollution prevention and control, biodiversity and ecosystems), followed by a section on questions relating to the generic DNSH criteria and a section on questions relating to the Taxonomy Disclosures Delegated Act. This last section includes a table showing the timeline for reporting requirements for non-financial and financial undertakings under the relevant legislation.

The Notice complements previous Commission Notices that have been published on the EU Taxonomy and its Delegated Acts so far: i.e.

- Commission Notice on the interpretation of certain legal provisions of the Disclosures Delegated Act under Article 8 of EU Taxonomy Regulation on the reporting of eligible economic activities and assets (**6 October 2022 - 2022/C 385/01**).

- Commission Notice on the interpretation and implementation of certain legal provisions of the Disclosures Delegated Act under Article 8 of EU Taxonomy Regulation on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets (**second Commission Notice**) (**20 October 2023 – C/2023/305**).

- Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Climate Delegated Act establishing technical screening criteria for economic activities that contribute substantially to climate change mitigation or climate change adaptation and DNSH to other environmental objectives (**20 October 2023 – C/2023/267**).

- Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the Sustainable Finance Disclosure Regulation (**16 June 2023 – 2023/C 211/01**).

- Commission Notice on the interpretation and implementation of certain legal provisions of the Disclosures Delegated Act under Article 8 of the EU Taxonomy Regulation on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets (**third Commission Notice**) (**8 November 2024 - C/2024/6691**) – see above, this was published in the Official Journal on 8 November 2024.

Non-financial services companies

Wider, non-financial services regulation will be relevant to alternative investment managers with portfolio companies. When it comes to the EU for instance, several measures are of ongoing interest and concern including: the EU Energy Efficiency Directive 2023, the EU Carbon Border Adjustment Mechanism, the EU Deforestation Regulation and data centre reporting requirements.

We addressed these EU measures, along with a number of other UK, EU and US issues you may be interested in, in our October 2024 webinar **Recent developments in ESG**. If you would like to watch this webinar, or others in our **Alternative Insights Autumn Webinar Series**, please contact your usual Travers Smith contact.

LUXEMBOURG FUNDS REGIME – A ROUND-UP OF KEY ESG DEVELOPMENTS

WHAT IS THIS? A round-up of CSSF initiatives in respect of ESG matters.

WHO DOES THIS APPLY TO? Luxembourg investment fund managers managing UCITS and/or AIFs.

WHEN DOES THIS APPLY? Various.

In addition to the EU developments discussed above, which will impact entities and individuals based in Luxembourg, we wanted to highlight the following Luxembourg-specific developments.

CSSF public sanction

The CSSF has for the first time publicly sanctioned a Luxembourg investment fund manager (a UCITS management company) for a lack of administrative procedures and control mechanisms allowing it to ensure compliance with the pre-contractual disclosures established in accordance with Article 8 of SFDR. The reasons for the sanction (a public fine) are:

- The portfolio of the fund included assets with an ESG score below the exclusion threshold mentioned in the SFDR pre-contractual disclosures.
- The measures put in place by the Luxembourg investment fund manager were not sufficient to make sure that the SDGs disclosed in the fund’s prospectus as "primarily targeted" were effectively primarily targeted by the fund.

While this sanction was given in the context of a UCITS fund, which with its retail investor base will necessarily attract a high degree of supervisory scrutiny, it should not be assumed that the CSSF will indulge non-retail managers who fail to comply with SFDR requirements. Alternative investment fund managers, who are subject to similar requirements regarding their procedures and controls mechanisms, could well find themselves targeted by CSSF onsite inspections. SFDR compliance, across all funds, will likely form a core part of the CSSF's monitoring activities going forward.

Funds' names using ESG or sustainability-related terms

On 21 October 2024, the Luxembourg regulator issued a communiqué confirming that it will apply the ESMA Guidelines (see above) in full. The ESMA Guidelines have been integrated into the CSSF's administrative practices and regulatory approach through Circular CSSF 24/863. The CSSF also announced a "priority processing procedure" (PPP) available for pre-existing AIFs and UCITS which is only available for amendments that must be made to the relevant prospectus or issuing document so as to comply with the Guidelines – i.e. the amendment(s) must be limited to either a name change of at least one sub-fund or minor changes to the fund's/sub-fund's ESG engagement or SFDR precontractual disclosure.

CSRD

The Luxembourg legislator is currently working on the bill of law 8370 relating to the implementation of CSRD in Luxembourg. Discussions are still ongoing, but the final version of the law should be published during Q1 2025. From what we have seen so far, Luxembourg is going to transpose CSRD in a way which closely follows the EU directive.

UK SDR AND INVESTMENT LABEL REGIME: UPDATE

WHAT IS THIS? The FCA's rules governing sustainability disclosures, a product labelling regime and an anti-greenwashing rule.

WHO DOES THIS APPLY TO? The anti-greenwashing rule applies to all FCA authorised firms. The other rules broadly apply – for the time being – to UK AIFMs and UK UCITS managers in relation to UK AIFs and UK UCITS; and the labelling regime is available to such mangers – all subject to the specific application provisions. Some additional rules apply to distributors when distributing products in the UK to retail investors. The FCA has consulted on extending the regime to segregated portfolio managers, with clarification about an implementation timetable expected in Q2 2025. A government consultation on further extending the regime to OFR funds is still awaited.

WHEN DOES THIS APPLY? The anti-greenwashing rule, and associated guidance, came into force on 31 May 2024. The labels became available from 31 July 2024 (with product-level disclosures for labelled products required from that date) and the naming and marketing rules and the product-level disclosure requirements for unlabelled products commenced on 2 December 2024. 'On demand' product-level sustainability information requests can be made from 2 December 2025 and the rules governing entity disclosures for asset management firms with assets under management of £50bn or over come into force on the same date. The rules governing entity disclosures for firms with assets under management of £5bn or more (but less than £50bn) come into force on 2 December 2026.

Application to UK funds and UK asset managers

The phased implementation of the UK Sustainability Disclosure Regime (**SDR**) and investment labels regime is well underway, with the following rules now in place for UK AIFMs and UK UCITS managers in relation to UK AIFs and UK UCITS:

- **31 May 2024**: the anti-greenwashing rule and associated guidance came into force (all firms)
- **31 July 2024**:
  - the labels became available for funds (with the associated disclosures requirements).
  - The naming rules started applying in relation to labelled products.
- **2 December 2024**:
  - The naming and marketing rules (with the associated disclosures requirements) started applying in relation to non-labelled products with ESG terms – retail only.

The remaining components of the regime – as it applies to asset managers – will come into force as follows:

- **2 December 2025**:
  - 'On demand' product-level sustainability information requests available.
  - Entity-level disclosures in force for firms with assets under management of £50 billion or more.
- **2 December 2026**:
  - Entity-level disclosures in force for firms with assets under management of less than £50 billion but £5 billion or more.

The labelling regime

As mentioned above, the labels became available for funds on 31 July 2024. On 1 November 2024, the FCA published The Sustainability Disclosure Requirements (SDR) and investment labels: pre-contractual disclosure examples – a good and poor practices paper. The brief introduction acknowledges that, since the new regime has no precedent, "naturally market practice is evolving" and that the examples in the papers are based on the FCA's experience of "applications to date" and are intended to aid applicants in preparing their documentation to meet the specific criteria required for a label to be granted.

Reading between the lines, and based on our understanding of what has been happening with Connect notifications to the FCA, while the FCA does not approve labels as such, a significant number of firms have been failing to meet the label criteria at the gateway. With the benefit of the good and poor practices paper and a growing number of labels being published which satisfy the detailed disclosure criteria, the "log jam" at the gateway is expected to clear, at least for the time being. However, managers obviously have an ongoing obligation to ensure that their labels remain appropriate. It seems likely that the FCA will be keeping the position under review and we may see further good/poor practice papers and/or thematic reviews in future.

A key issue – indeed, something of a litmus test for SDR as a whole – will be the rate of adoption of labels by asset managers. So far, the picture is mixed, with some prominent firms having opted not to pursue a label.

Extension of the SDR and labelling regime to portfolio management

As we reported in our May 2024 briefing **SDR and investment labels: extension of the regime to UK portfolio managers | Travers Smith**, the FCA, as it had promised, set out its proposals to apply the substance of the regime to portfolio management, aligned as far as possible with that for asset managers. The consultation closed on 14 June 2024.

In the consultation, the FCA had proposed that the extension to portfolio managers would broadly fall into a similar timeline as that for asset managers (with labels being available as from 2 December 2024 and the naming and marketing rules applying to non-labelled products as of that date, and entity level disclosures for large managers applying as from 2 December 2025).

However, in September 2024, the FCA issued an update saying that it was considering the feedback it had received and intended to publish a policy statement and "further information about implementation" in **Q2 2025**. The delay was put down to the fact that comments the regulator had received from the industry indicated that it is "taking longer than expected" for some asset managers to comply with the first implementation phase of SDR and the labelling regime and of the consequential impact this might therefore have on portfolio managers. We will have to wait until Q2 to hear "further information", but it is possible that the FCA may be gearing up to consult again on exactly how the extension will apply to portfolio management and, among other things, this could include revisiting the intended scope.

Extension of regime to OFR funds

In May 2024, in their roadmap to implementing the Overseas Funds Regime, HM Treasury and FCA announced that the government intended to consult on whether the UK SDR requirements and labelling regime should be extended to OFR funds. At the time, they said that the consultation was likely to run from Q3 2024. As of January 2025, the government consultation is still awaited. Given what the FCA has said about it taking longer than expected for some UK asset managers to comply with the first implementation phase of SDR and the labelling regime (see above), it seems likely that the FCA is waiting for that first phase to bed down more securely before looking to extend it to OFR funds. Whenever the consultation does take place, if the government decides, following feedback, to extend the regime to OFR funds, the FCA will itself need to consult on rules giving effect to that extension.

FCA quarterly consultation on clarificatory changes to anti-greenwashing rule and SDR

On 6 December 2024, the FCA's Quarterly Consultation CP24/26 included a number of proposed corrections and clarificatory amendments to the Anti-greenwashing Rule and the Sustainability Disclosure Requirements (**SDR**). Consultation on these changes, which are minor, closes on **13 January 2025**.

The proposed amendments are intended to be clarifications and amendments designed to correct some unintended consequences of the way that some rules were drafted, which conflict with the FCA's original policy proposals:

- *Application of the anti-greenwashing rule*: this rule applies to (a) a firm that *communicates* with a UK client in relation to a product or service or (b) to the communication (or approval) of a financial promotion to a UK person. Currently, the word "*communicates*" in (a) is erroneously italicised (the Glossary definition of "*communicate*" specifically relates to financial promotions). The italicisation will be removed to give effect to the policy intention that the first limb of the application rule should apply to all communications to clients. As regards (b), the financial promotion limb of the application rule, this will be conformed with the application of the general "fair, clear and not misleading" rule in COBS 4.2.1R to financial promotions by excluding a financial promotion that is an "excluded communication" (i.e., broadly, one that would benefit from an exclusion under the Financial Promotion Order were it communicated by an unauthorised person or an exclusion under the Promotion of Collective Investment Schemes Order) or a "third-party prospectus" (i.e., broadly one that has been approved by the FCA or is to be treated as having been so approved in accordance with recital 73 to the MiFID Org Regulation). It is welcome that the scope and application of the anti-greenwashing rule will be made expressly consistent with that of the fair, clear and not misleading rule (in this respect at least). However, an inherent tension remains between the apparent scope of the two limbs leading to a concern that excluded communications under limb (b) will still be caught by the anti-greenwashing rule by virtue of the breadth of limb (a), which would entirely negate the effect of the conforming change. Even if this tension is resolved by the FCA, and the anti-greenwashing rule is intended to be disapplied in the context of excluded communications, this will only help to the extent that a firm's financial promotion is fully covered by one or more FPO or PCIS exclusions.

- *Pre-contractual disclosures – KPIs and retail clients*: one of the sets of information that a manager is currently required to include in its pre-contractual disclosures relates to KPIs: the "details of the KPIs that the manager will use under ESG 4.2.4R(3) **and/or** other metrics that a retail client may reasonably find useful in understanding the manager's investment policy and strategy for the product". ESG 4.2.4R(3) refers to the "robust and evidence-based KPIs" that a **labelled** product must have and which demonstrate that product's progress towards meeting its sustainability objective. The "and/or" suggests that a manager of a labelled product can choose whether to point to such KPIs, or to "other metrics" that a retail client may find useful. The FCA proposes to clarify that the obligations are independent of one another so that managers of labelled products must disclose KPIs that a retail client may find useful *in addition to* the robust and evidence-based KPIs demonstrating the fund' progress towards meeting its sustainability objective.

- *Product-level sustainability report – additional time to produce first report*: where a manager uses a sustainability label or a sustainability-related term in the fund's name, it must publish its first product-level sustainability report within 12 months from the first use of the label or sustainability-related name. Each sustainability report must cover a full 12 months' reporting period. In recognition of the fact that the effect of these two requirements taken together means that managers might find themselves having to include a period of time during which the fund was not using a label or a sustainability-related term in the fund name, the FCA is proposing to relax the first publication deadline. Instead, managers will have **16 months** from the start of using a label or a sustainability-related term in the fund name in which to publish the first product-level sustainability report. Thereafter, product reports should continue to be published on an annual basis.

- *Managers of feeder funds and naming and marketing rules*: where the in-scope manager of a feeder fund intends to use one of the sustainability-related terms listed in ESG 4.3.2R(2) in the product's name, a rule currently requires it, among other things, to publish required standardised explanations on the manager's webpage, mobile app or other digital medium though which the fund is offered (crossreferring to another rule requirement). The FCA proposes to clarify that this only applies if the manager is not using a sustainability label (consistent with the application of the rule to which this additional requirement cross-refers).

- *Distributors and retail clients*: where a recognised scheme, or a financial promotion in relation to such a scheme uses one of the sustainability-related terms listed in ESG 4.3.2R(2) (e.g. "ESG", "climate", "green" etc), any distributor that distributes such a scheme must display **both** the prescribed notice on its webpage, mobile app or other digital medium through which the scheme is offered **and** include a hyperlink to the relevant FCA webpage setting out further details on the sustainability labelling and disclosures for retail clients (at the moment the drafting suggests that it is an "either/or" choice).

UK REGULATION OF ESG RATINGS PROVIDERS

WHAT IS THIS? The proposed UK regime for the regulation of ESG ratings providers.

WHO DOES THIS APPLY TO? Any UK ESG ratings provider which "makes available" ESG ratings to UK and non-UK users; any non-UK ESG ratings provider which "makes available" ESG ratings to UK users.

WHEN DOES THIS APPLY? Not for several years. In the recent response document, the Treasury says that the process of designing, developing and commencing the ESG ratings regulatory regime is expected to take approximately four years (so it is likely that the EU regime for ESG ratings providers will be in force before the UK one) The Treasury intends to lay secondary legislation in early 2025 after which the FCA will develop and consult on how it will regulate ESG ratings providers within the perimeter.

As we previously reported, in March 2023 HM Treasury published a consultation on the Future regulatory regime for Environmental, Social and Governance (ESG) ratings providers. The consultation set out the initial policy proposals for the scope of a regulatory regime governing ESG rating providers.

On 14 November 2024, the UK government published its Consultation Response which was accompanied by a draft Statutory Instrument on which technical comments were sought, with a deadline for responses of **14 January 2025**. The FCA welcomed the move to bring ESG ratings providers into regulation and committed to working with the government on the next steps. When the legislation is finalised the FCA will consult on proposed standards and regulatory requirements that will apply to ESG ratings providers.

Reminder: the core policy proposal – extending the perimeter

The core policy proposal in the consultation was that the direct provision of an assessment of ESG factors to a user in the UK, where the assessment is used in relation to a specified investment, should be brought into regulation, unless an exclusion applies. The Regulated Activities Order would be amended. The draft Statutory Instrument on which comments are sought is the draft Financial Services and Markets Act 2000 (Regulated Activities)(Amendment)(No.2) Order 2024.

What follows is a summary of the Treasury's position based on its Consultation Response and the draft Statutory Instrument.

Description of ESG ratings and their provision

The definition of an ESG rating has been narrowed in the light of responses to the consultation which suggested that the initial definition was too broad and capable of being interpreted in different ways. The definition embeds two terms that are themselves defined terms:

- "**ESG rating**" means an assessment regarding one or more ESG factors, produced in the form of an **ESG opinion**, an **ESG score** or a combination of both, whether or not it is characterised as an ESG rating.

- "**ESG opinion**" means an ESG rating involving substantial analytical input from an analyst, whether or not it is characterised as an ESG opinion.

- "**ESG score**" means an ESG rating derived from data and a pre-established statistical or algorithmic system or model, without additional substantial analytical input from an analyst, whether or not it is characterised as an ESG score.

Despite the narrowing, the definitions will still capture a wide range of assessments, whether they are called "ratings", "scores", "marks", or anything else. In other words, what matters is not (necessarily) what the assessment is called, but what it does in substance. The government's intention is to catch both general ESG ratings products, such as aggregate ESG ratings on corporates or funds, and specific ratings products such as biodiversity or controversy scores.

However, in line with the consultation, data on ESG matters where no assessment is provided would be exempt, as would data which is only minimally processed (e.g. by formatting or summarising) provided there is no separate provision of an assessment. In other words, regulation will apply to the *provision of ESG ratings* only and the mere provision of ESG data will not be caught.

The activity of providing an ESG rating

The new specified activity of "providing an ESG rating" (which will be inserted in article 63U of the Regulated Activities Order) will apply to the provision of an ESG rating where that rating is produced using an established methodology and defined ranking system of rating categories, which is made available by an ESG rating provider in the UK (see below for the territorial scope) and which is "likely to influence a decision to make a specified investment", unless the provider could not reasonably have expected the ESG rating to influence a decision to make a specified investment.

This last limb ("likely to influence") is a change from the consultation, where the proposal had been to capture ESG ratings used by a person in the UK *in relation to a specified investment under the Regulated Activities Order* which would have required providers to be sighted as to their ratings' eventual and actual use. The activity now turns on a more objective, reasonableness test. The examples given in the Consultation Response are of a rating that is likely to be used to inform asset allocation and portfolio construction and pre-IPO ratings.

The draft Regulated Activities Amendment Order circulated with the Consultation Response includes an exemption to the effect that a person will not require permission to provide an ESG rating if done in the course of carrying on another regulated activity. This is a point of difference with the EU regime: the UK proposes to include a "hard" exemption for (e.g.) an authorised manager providing proprietary ESG ratings or scores – no additional, specific article 63U permission would be required (although as the note on the face of the draft legislation points out, the FCA may decide to enhance the rules applicable to the other activities in light of the additional ESG rating activity).

Territorial scope – UK ratings providers which make their ratings available to UK and non-UK users

UK ratings providers which make their ratings available to users in the UK will be caught. In a change from the consultation, they will also be caught when they make their ratings available to non-UK users. They will be subject to regulation regardless of the way in which they make their ratings available (for example, whether paid for or provided for free or whether they are bundled with other services or provided discretely). In other words, a business relationship is not a prerequisite.

Territorial scope – non-UK ratings providers which make their ratings available to UK users

Overseas ratings providers which make their ratings available to users in the UK will be caught. However, they will only be deemed to have made their ratings available to UK users if they have done so by way of a "business relationship", which *includes* by way of subscription or other contractual relationship, for instance where it is paid for by the UK user on a bundled or unbundled basis. In this context, "made available" (by the non-UK ESG provider) is further clarified as including through the use of third party distributors (where the provider could reasonably have expected the rating to be made available to a UK person).

While the above summarises the statutory scope, the precise application of the regulatory requirements will be a policy consideration for the FCA on which it will consult at a later date. The government's Consultation Response mentions the fact that the FCA will be exploring whether – if the size, significance or potential market impact of the relevant applicant for UK authorisation justifies – the non-UK ratings provider may be required to establish a subsidiary in the UK.

Territorial scope – distributors

The "made available" formulation is new. In the consultation, the government had proposed that the "direct provision" of ratings would be caught, meaning that intermediaries and distributors would have been on the hook for the direct provision of ratings they had not themselves produced. The final draft statutory instrument makes it clear that the regulated activity applies to ESG ratings providers who both *produce* and *make their ratings available* (as above). While a distributor will be involved in the "making available", it will not have produced the rating and so will not be caught.

Exclusions

The draft statutory instrument contains six express exclusions on which technical comments are invited (these are in addition to the *de facto*, "embedded" exclusion in the specified activity of providing an ESG rating itself – i.e. the provider will not carry on the specified activity if they could not reasonably have expected the ESG rating to influence a decision to make a specified investment). Although the substance of some, but not all, of the exclusions consulted on have been carried forward, the detailed text is quite different in parts.

- *Regulated products or services* – where a person provides a rating *in the course of carrying on* another regulated activity, an activity which is subject to FCA approval (e.g. under a provision of assimilated law (previously known as "retained EU law")), or an activity which is within the scope of a market access arrangement (see below) then they will be excluded from having to get separate permission for the activity of providing an ESG rating. However, the exclusion only applies to the extent that the provision of the rating is genuinely part of that other activity (for instance, in the product or explanation of a credit rating or benchmark): ratings provided as a standalone product or service will not be covered, and separate permission will be required notwithstanding the firm may already be authorised by the FCA.

  - *Avoidance of dual regulation:* The government's policy rationale for this exclusion is that it would be disproportionate to require "dual authorisation", although in the absence of the exclusion, for an entity that is already authorised under FSMA it would not be a question of dual authorisation as such, rather a requirement to obtain additional, specific Part 4A permission.

  - *Market access arrangements:* The government believes that there are three main products and services provided by overseas firms under UK market access arrangements which might be suitable for this regulated products or services exclusion: the Overseas Funds Regime (**OFR**), Credit Rating Agencies, and Benchmarks. As regards managers of OFR recognised funds, the exclusion would allow them to produce ratings for use with end investors provided that such ratings are genuinely produced in the course of their OFR fund management business.

- *Intra-group ratings* – there will be an exclusion for providing ESG ratings to another member of the provider's group, as long as the provider reasonably expects that the rating will not be made available to anyone outside the group.

- *Private use* – a provider will be excluded if they have contracted with a single entity to provide an ESG rating exclusively related to that entity (according to the government's narrative but not the draft statutory instrument, at that entity's *solicitation*), as long as the provider reasonably expects that the rating will not be made available to anyone outside the relevant entity's group.

- *Ancillary non-commercial provision* – this exclusion will be available for journalists, academics and charities although the government emphasises that it is testing it further for any "loopholes".

- *Public authorities, central banks and international organisations*

- *Accreditation or certification* – if an ESG rating is developed exclusively for accreditation or certification processes and the purpose of the accreditation or certification is not to influence an investment decision, an exclusion will apply. The example given is that of an Energy Performance Certificate.

FCA regulation of ESG rating providers within the perimeter

Once the statutory instrument has been finalised, the FCA will be consulting – in 2025 – on the rules that will apply to those ESG rating providers who will be authorised to carry out the regulated activity of direct provision of an assessment of ESG factors to a user in the UK.

UK GREEN TAXONOMY – LET'S GO ROUND AGAIN

WHAT IS THIS? A government consultation seeking views about the fundamental rationale for having a UK taxonomy and its use cases.

WHO DOES THIS APPLY TO? Corporates, asset managers and asset owners (as well as investment products). GTAG to had recommended that UK Green Taxonomy reporting should apply to companies subject mandatory TCFD reporting.

WHEN DOES THIS APPLY? The consultation closes on 6 February 2025. It is not yet certain whether the government will proceed with a UK Green Taxonomy. If it does, further, more detailed consultation will be required with the final output likely to be years, rather than months, away.

We reported in last year's New Year Briefing that, in the 2023 Green Finance Strategy, the Government had said that it expected to consult on the UK Green Taxonomy "in Autumn 2023" but that by the middle of winter no consultation paper had been published. It was not until late Autumn 2024 – after a change of Government – that a consultation finally emerged and, when it did, it was perhaps not the detailed, technical set of proposals that one might have expected, especially given the amount of work that had been undertaken by the Green Technical Advisory Group (**GTAG**) during 2022 and 2023.

Instead, the slim consultation pretty well returns to square one to ask some really quite fundamental questions about whether a UK taxonomy is needed at all and, if so, what it should be used for. The government is "aware that taxonomies can be complex in practice, and feedback on their value is mixed". It wants to learn the lessons from taxonomy implementation in other jurisdictions, not least the EU.

The consultation therefore seeks views on whether a UK Green Taxonomy would be additional and complementary to existing sustainable finance policies – and "distinctly valuable" – for instance by enabling market participants to make sustainable investment decisions, and the specific market and regulatory use cases which facilitate this; the answers to these questions will inform an assessment of the value of implementing a UK Taxonomy, and exactly how it could be targeted to ensure it is as effective as possible.

Consultation closes on **6 February 2025**. It was back in October 2021 that HM Treasury, the Department for Work and Pensions and the Department for Business, Energy & Industrial Strategy had published their joint paper entitled Greening Finance: A Roadmap to Sustainable Investment which, in addition to a new Sustainability Disclosure Regime, proposed a UK Green Taxonomy. The then newly-established Green Technical Advisory Group (**GTAG**) was tasked with providing non-binding guidance to the government as to the considerations for developing and implementing the UK Green Taxonomy. In October 2022, in addition to other things, GTAG advised on Taxonomy use cases. Two years later, despite considerable work undertaken by GTAG in the interim, it is perhaps unsurprising that the new government wishes to pause and reconsider the commitments of the previous government and to test those use cases (and, potentially, others) with a view to re-evaluating the utility of having a UK taxonomy in the context of the many other initiatives on sustainable finance.

ADOPTION OF INTERNATIONAL SUSTAINABILITY DISCLOSURE STANDARDS AND TRANSITION PLANS: THE ROAD TO HEAVEN IS PAVED WITH GOOD INTENTIONS?

WHAT IS THIS? An update on UK policy and intentions on corporate sustainability disclosure requirements, and specifically transition plans.

WHO DOES THIS APPLY TO? The first entities subject to the new UK Sustainability Reporting Standards are likely to be UK-listed companies, following the FCA consultation. But the scope and application will undoubtedly be expanded to include UK financial institutions.

WHEN DOES THIS APPLY? Consultations are expected in H1 2025; but the timeline for implementation remains uncertain

In May 2024, the previous government had issued a Sustainability Disclosure Requirements: Implementation Update 2024 (and, as if to distance itself from the anticipated timeline at least, if not the policy intentions, an emboldened banner on the gov.uk website warns that "this was published under the 2022 to 2024 Sunak Conservative government"). The present government has so far been less explicit about a timeline, although the policy direction of travel is not dissimilar to that of its predecessor: in its UK Green Taxonomy consultation (see above) it says that it intends to consult on requiring "economically significant companies" to disclose information using **future UK Sustainability Reporting Standards**, which will be based on the above "internationally operable" ISSB standards. In December 2024, the technical group advising the government issued its final recommendations to the Secretary of State for Business and Trade, recommending endorsement of the first two IFRS Sustainability Disclosure Standards for use in the UK with only minor amendments – adoption seems likely fairly early in 2025. The FCA will also be using those standards to consult on updated disclosures for UK-listed companies in 2025.

The **Transition Plan Taskforce** wound up its work on 31 October 2024 with the delivery of its final publication, Progress Achieved and the Path Ahead: The Final Report of the Transition Plan Taskforce. However, while the work of the TPT is over, as the final report emphasised, the story does not end there: there is a growing momentum in the UK for the building of transition plans and reaching climate-related policy and supervisory objectives. The finalised TPT Suite of Publications underpins the process by which firms may build "robust and credible" transition plans.

That suite of documents is now maintained by the **International Financial Reporting Standards** (**IFRS**) **Foundation** on its knowledge hub: this includes the TPT Disclosure Framework (October 2023) (which sets out good practice for robust and credible transition plan disclosures, providing guidance on how to report in line with the transition plan-related aspects of IFRS S2 Climate-related Disclosures) and the Asset Managers Sector Guidance (April 2024). That assumption of responsibility is part of the work of the **International Sustainability Standards Board** (**ISSB**), the standard-setting board of the IFRS Foundation. By way of reminder, ISSB published the first two IFRS Sustainability Disclosure Standards in June 2023:

- IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information.
- IFRS S2: Climate-related disclosures.

In its June 2024 Manifesto, the Labour Party included a commitment to "make the UK the green finance capital of the world, mandating UK-regulated financial institutions – including banks, asset managers, pension funds, and insurance – and FTSE 100 companies to develop and implement **credible transition plans** that align with the 1.5 degrees centigrade goal of the Paris Agreement". The government will be consulting in **H1 2025** on how to take this commitment forward.

On 17 October 2024, the **Transition Finance Market Review** – commissioned by the previous government – published Scaling Transition Finance: Findings of the Transition Finance Market Review. The Review was focused on how the UK can become the best place to raise transition capital (in line with the Labour Party's manifesto commitment). Several barriers to scaling transition finance were identified together with a set of tools and recommendations as to achieve to overall objective, including:

- The development of:
    - A Transition Finance Classification System (**TFCS**) which builds on the four GFANZ transition finance strategies (financing or enabling: (i) the development and scaling of climate solutions (ii) assets or companies already aligned to a 1.5 degree Celsius pathway; (iii) assets or companies committed to transiting in line with 1.5 degree Celsius pathways; and (iv) the accelerated managed phaseout of high-emitting physical assets). The TFCS is illustrative and is not intended to replicate or replace a taxonomy-style classification (the Review incidentally recommends that the government consults on the use cases for a UK Green Taxonomy which, as outlined above, it has done).
    - A set of principles-based Guidelines for Credible Transition Finance which the Review recommends the Transition Finance Council should take forward and finalise.
    - Insurance products to cover the risks associated with transition activities.
- The recommendation that:
    - The government should – **by Q1 2025** – publish its findings of its talks with industry about the structure of the UK's net zero framework, and whether it needs adjustment.
    - The government should consider leveraging the developing global framework for national transition planning and should use an update to the Carbon Budget Delivery Plan in Spring 2025 to announce its conclusions in this regard.
    - The regulators, in collaboration with UK financial institutions, should actively engage with the European Commission, the European Securities and Markets Authority (**ESMA**) and the European Platform for Sustainable Finance in the review of EU SFDR, looking for convergence with the UK regime "where possible".
    - As regards the UK SDR and labelling regime, the market should, where appropriate, actively seek to use the "Sustainability Improvers" label.
- The establishment of:
    - A private sector-led Transition Finance Lab, within the Green Finance Institute, to design, develop and test finance structures.

- The Net Zero Council (actually, a reinstatement of the body first established in May 2023) which will be responsible for consulting with industry in the development of national and sectoral decarbonisation pathways and planning, and feeding back on the barriers to, and enablers of, scaling transition finance.
- A Climate Financial Risk Forum (**CFRF**) transition finance working group to work with the regulators and the market in setting up and developing key transition finance metrics.
- A Transition Finance Council, based in the City of London Corporation, to oversee the delivery of the Review's recommendations (see below).

Both the government and the FCA have welcomed the report and its recommendations. In her Mansion House speech on 14 November 2024, one of the Chancellor's announcements related to the launch of the Transition Finance Council with the City of London Corporation, in line with one of the Review's recommendations. The government says it will be considering the other recommendations "over the coming months".

Other transition-related developments in 2024 included the publication by the Taskforce on Nature-related Financial Disclosures (**TNFD**) of a discussion paper on nature transition plans (open for consultation until **1 February 2025**) and a consultation paper from the Glasgow Financial Alliance for Net Zero (**GFANZ**) on supplemental guidance on Nature in Net-zero Transition Plans (open for consultation until **27 January 2025**). At the same time, GFANZ also published a consultation on Index Guidance to Support Real-Economy Decarbonization (closes on 9 January 2025) which cross-refers and links to an associated set of Case Studies on Transition Finance and Decarbonization Methodologies that had been published in September 2024.

For more on the Chancellor's Mansion House speech, see or listen to our briefing **Alternative Insights: The UK government's boost to private markets** and for further information on transition finance see or listen to our briefing **Sustainability Insights: The role of government in transition finance**.

UK SUSTAINABILITY – NON-FINANCIAL SERVICES COMPANIES AND UK ESOS

WHAT IS THIS? The Energy Savings Opportunity Scheme.

WHO DOES THIS APPLY TO? This is, broadly, of relevance to companies that are large UK undertakings and their corporate groups (see below for details).

WHEN DOES THIS APPLY? Large undertakings had until 6 August 2024 to issue their notifications of compliance. The first ESOS Action Plan must be submitted by 5 March 2025 at the latest; the first annual update must be submitted by 5 December 2025 (with updates to the previous submission being made by 5 December in subsequent years).

In addition to the Companies Act sustainability reporting changes outlined above, non-financial services companies (for instance, UK portfolio companies) are potentially subject to other requirements. One of these is the Energy Savings Opportunity Scheme (**UK ESOS**). Broadly speaking, UK ESOS applies to large UK undertakings (and their corporate groups). UK registered establishments of an overseas company, regardless of size, will also be caught if any other part of their global corporate group activities in the UK meet the relevant qualifying criteria.

For the third compliance period of UK ESOS (known as ESOS Phase 3) a large undertaking is any UK company that, on 31 December 2022, either:

- Employed 250 or more people; or
- Had an annual turnover in excess of £44 million, and an annual balance sheet total in excess of £38 million.

The final, extended deadline for such large undertakings to issue their notifications of compliance with UK ESOS was 6 August 2024.

For Phase 3 onwards, there will be a new obligation to prepare and keep updated an **ESOS Action Plan**. Detailed guidance on this requirement is set out in section 12 of the government Guidance. The ESOS Action Plan must set out *what* the UK company intends to do to reduce energy consumption and *when* it intends to do this, whether this was recommended through the company's ESOS assessment, what energy savings the company expects to achieve over the period covered by the action plan, and how the company estimated those savings. The first ESOS Action Plan must be submitted by **5 March 2025** at the latest (although the Environment Agency was still encouraging companies to submit them by the original deadline of 5 December 2024). Thereafter, annual updates must be made, meaning that the update to the first ESOS Action Plan must be submitted by **5 December 2025**, with updates to the previous submission being made by 5 December in following years.

Further details and commentary is set out in our September 2024 briefing **From energy savings opportunity to energy savings requirements?** We also addressed UK ESOS (along with other issues impacting upon portfolio companies) in our October webinar **Recent developments in ESG.** If you would like to watch this webinar, or others in our **Alternative Insights Autumn Webinar Series**, please speak to your usual Travers Smith contact.

US: BLUE STATE, RED STATE, WHITHER ESG? THE CALIFORNIA CLIMATE DISCLOSURE RULES

WHAT IS THIS? Two Acts: the Climate Corporate Data Accountability Act and the Climate-related Financial Risk Act which respectively mandate the disclosure of greenhouse gas emissions and climate-related financial risks and mitigating measures adopted.

WHO DOES THIS APPLY TO? Public and private entities doing business in California.

WHEN DOES THIS APPLY? 1 January 2026, although as regards the Climate Corporate Data Accountability Act CARB are required to adopt regulations by 1 July 2025, with the first reporting deadline of scopes 1 and 2 emissions "in 2026" and for scope 3 emissions "in 2027". CARB has recently issued a notice announcing that it will be exercising its enforcement discretion as regards "incomplete reporting" in the first report due in 2026, allowing in-scope entities to use emissions from the previous fiscal year provided they make a "good faith effort" to retain all relevant data.

Roses are red and violets are blue, but when it comes to the so-called "red states" and "blue states" in the US, and their attitude to ESG matters, this may not perhaps be quite such a binary (or poetic) matter. However, there does appear to be a fundamental division of opinion along broadly political lines between "red states" and "blue states" when it comes to such matters and against that backdrop – and in light of the election at the federal level of Donald Trump – the "blue state" of California has recently finalised two key pieces of disclosure legislation that will affect companies operating in that state, while a number of red states have recently commenced litigation against three leading institutional investors for manipulating the US coal markets in pursuance of ESG policies.

The Climate Corporate Data Accountability Act (Senate Bill 253) will require annual public reporting of greenhouse gas emissions (Scopes 1, 2 and 3) by US companies (public and private) doing business in California. Technically, it adds a new Section 38532 to the Health and Safety Code.

The Greenhouse Gases: Climate-related Financial Risk Act (Senate Bill 261) will require annual public reporting of the threats faced by such US companies as a result of climate change. Technically, it adds a new Section 38533 to the Health and Safety Code.

It should be noted that that legislation has been challenged in court and, although a motion for summary judgment to have them both declared constitutionally invalid under the US First Amendment was denied towards the end of 2024, further litigation may follow and so not inconsiderable uncertainty remains.

Legislation which amended the above two bills (Senate Bill 219) was approved by the Governor and signed on 27 September 2024. Among other things, as amended:

- The Climate Corporate Data Accountability Act requires the California Air Resources Board (**CARB**) to develop and adopt, by 1 July 2025, regulations requiring businesses operating in California with **total annual reporting revenues of over $1 billion** to report their greenhouse gas emissions to an emissions reporting organisation or to CARB itself.

- The Greenhouse Gases: Climate-related Financial Risk Act requires businesses operating in California with total annual revenues of over **$½ billion** to prepare a report disclosing the climate-related financial risks faced by the business and any measures adopted to reduce and adapt to climate-related financial risk.

Despite attempts to delay implementation, the first reporting deadline for in-scope entities was not extended and remains, under both measures, **1 January 2026**. However, CARB was granted an extension of 6 months (from 1 January 2025 to 1 July 2025) in which to propose and adopt the requisite implementing regulations for the purposes of the Climate Corporate Data Accountability Act and the reporting deadline for in-scope companies (as regards scope 1 and scope 2 emissions for the previous fiscal years) is expressed as "starting in 2026 on or by a date to be determined by the state board". The timing of disclosures for scope 3 emissions will be 2027 (in respect of data collected in 2026). Reporting after those dates is required annually. The deadline for climate-related disclosures remains "on or before 1 January 2026", with biennial reporting thereafter.

On 5 December 2024, CARB issued an Enforcement Notice in which it announced that it has decided to exercise its enforcement discretion (under the Health and Safety Code) such that, for the first report due in 2026, a reporting entity may submit its scope 1 and scope 2 emissions from its prior fiscal year determined by information already in its possession, or which it is already collecting, as of the date of the notice. CARB will not take enforcement action for the first reporting cycle in respect of incomplete reporting against entities, provided that the companies make a "good faith effort" to retain all data relevant to emissions reporting for the entity's prior fiscal year. Details on reporting for subsequent reporting cycles will be set out in CARB's rules at a later date.

We understand that laws similar to the California Climate Corporate Data Accountability Act are proposed in certain other "blue states": New York, Illinois and Washington. Meanwhile, the Attorney General in Texas (together the Attorneys General of 10 other "red states") has recently commenced legal action against the institutional investors BlackRock Inc, State Street Corporation and The Vanguard Group, Inc for allegedly conspiring to manipulate the energy markets (by allegedly suppressing product in the coal market using anticompetitive trade practices in purported furtherance of ESG practices, thereby increasing the price of electricity).

We addressed the California Climate Disclosures Acts, along with a number of other UK, EU and US issues you may be interested in, in our October 2024 webinar **Recent developments in ESG**. If you would like to watch this webinar, or others in our **Alternative Insights Autumn Webinar Series**, please contact your usual Travers Smith contact.

3 INVESTMENT FUNDS

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
2025	UK AIFMD	Publication of UK AIFMD review expected
1 January 2025	CSSF rules	Circular CSSF 24/856 with guidelines on errors starts to apply
12 March 2025	EU AIFMD II – open-ended loan-originating AIFs	ESMA's consultation on draft RTS on open-ended loan-originating AIFs closes
By 16 April 2025	EU AIFMD II	Final LMT RTS and LMT Guidelines expected to be submitted for endorsement
H1 2025	UK Stewardship Code	New UK Stewardship Code expected to be published
H1 2025	UK retail disclosure	New retail disclosure rules expected to start to apply
H1 2025	Extension of the FCA's investment research payment optionality to fund managers	FCA aims to publish rules or guidance on the extension (if it decides to proceed) – the new rules may take effect immediately
1 December 2025	EU funds	EU Regulation on Investment Fund Statistics starts to apply
Late 2025	EU AIFMD II	Final report on open-ended Loan Originating AIFs expected
1 January 2026	UK Stewardship Code	New UK Stewardship Code expected to become effective
16 April 2026	EU AIFMD II	EU AIFMD II starts to take effect
2026	EU Retail Investment Strategy	Possible date for changes to start to apply

ITEMS COVERED IN THIS SECTION

EU ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE

WHAT IS THIS? Amendments to EU AIFMD including new requirements and restrictions for AIFs which originate loans, enhanced delegation requirements and additional disclosure and reporting requirements.

WHO DOES THIS APPLY TO? EU full-scope AIFMs with some provisions also applying to non-EU AIFMs marketing under National Private Placement Regimes.

WHEN DOES THIS APPLY? 16 April 2026.

AIFMD II, which amends certain aspects of the existing Alternative Investment Fund Managers Directive (**AIFMD**), has now entered into force and will start to take effect as from 16 April 2026.

Key changes under AIFMD II include:

- New requirements for AIFs which originate loans including concentration limits, prohibitions on certain types of loans, risk retention requirements and new policies and procedures requirements. Additional requirements apply in respect of AIFs which originate loans on a material basis (**Loan Originating AIFs**) including leverage limits (175% for open-ended AIFs and 300% for closed-ended AIFs) and a requirement to be closed-ended. Some exceptions and grandfathering provisions apply.

- New rules on liquidity management for open-ended funds with AIFMs managing open-ended AIFs required to select two liquidity management tools (**LMT**) from a specified list and have policies and procedures for their use. These are: redemption gates; extension of notice periods; redemption fees; swing pricing or dual pricing; anti-dilution levy; and redemption in kind (for professional investors only). Separately, AIFMs may also in certain circumstances suspend subscriptions, repurchases and redemptions or activate side pockets. Money market funds (**MMFs**) are only required to adopt one LMT.

- New permitted activities of originating loans and servicing securitisation SPVs. There are also new top-up permissions of benchmark administration under the EU Benchmarks Regulation, credit-servicing under the EU Credit Servicers Directive and any other service already provided by the AIFM in respect of the AIFs it manages or related to its top-up permissions.

- Enhanced disclosure and reporting requirements including enhanced Annex IV reporting obligations requiring complete data on portfolio composition as well as information on leverage, delegation arrangements and marketing. Also new investor disclosure requirements.

- Requirement for the performance of delegated functions to comply with AIFMD irrespective of the delegate's location or regulatory status.

The changes are largely relevant for EU full-scope AIFMs but some of the changes will also affect non-EU AIFMs marketing into the EU under National Private Placement Regimes.

Attention is now turning to the supplementary rules and guidance and, so far, we have seen publications in respect of the new requirements for LMT as well as open-ended Loan Originating AIFs.

New requirements for LMT

ESMA has published a Consultation Paper on Draft Regulatory Technical Standards on LMT (**LMT RTS**) and a Consultation Paper on the Guidelines on LMTs of UCITS and open-ended AIFs (**LMT Guidelines**) which set out further details on the characteristics and use of those LMTs.

The draft LMT Guidelines state that, when selecting LMTs, the AIFM should ensure that they are suitable for the AIF based on a number of factors including:

- The AIF's investment strategy and investment policy.

- The structure of the AIF including notice period, lock up period, settlement period and dealing frequency.

- The liquidity profile of the AIF and its underlying assets, as well as liquidity demands.

- The AIF's redemption policy, investor base and distribution policy.

The draft LMT Guidelines also provide that the AIFM should consider, where appropriate, the merits of selecting at least one quantitative-based LMT (e.g. redemption gates, extension of notice period) and at least one anti-dilution tool (e.g. redemption fees, swing pricing, dual pricing, anti-dilution levy). Similarly, the AIFM should also consider whether to select one LMT to use under normal market conditions and one LMT to be used under stressed market conditions. Although these are expressed as considerations rather than obligations, there is some concern that ESMA or member states may interpret them as mandatory in nature which could limit AIFMs' ability to choose the LMTs that they consider most appropriate.

The draft LMT Guidelines also include guidance on the LMT policies and procedures, the activation and calibration of the LMTs and required disclosures to investors.

The draft LMT RTS include details of the features of the mandatory LMTs. These include:

- For *redemption gates*, which are defined in AIFMD II as temporary and partial restrictions on the right to redeem, proposed features include an activation threshold predefined as net redemption orders for a given dealing date in proportion to the net asset value (**NAV**) of the AIF which is to be disclosed in the AIF's rules, offering documents or instruments of incorporation. Once the activation threshold is triggered, the redemption gate may either be automatically activated or activated at the discretion of the AIFM (which can also activate redemption gates at a higher level).

- For *extension of notice periods* when redeeming units, the same extension period should apply to all unitholders and (if relevant) all share classes and not include the settlement period.

- For *redemption fees*, the fee should be based on the explicit and implicit estimated costs of portfolio transactions caused by redemptions, including any estimated significant market impact of assets sales. The redemption fee should be expressed as a percentage of the redemption orders of unitholders and may be expressed as a range with a minimum (but not 0) and a maximum percentage. The methodology should be disclosed in the fund documentation and prospectus.

- For *swing pricing*, this is based on a swing factor expressed as a percentage of NAV and on the explicit and implicit estimated costs of portfolio transactions caused by subscriptions or redemptions. Either full swing or partial swing could be used. Details of the activation of swing pricing, in both normal and stressed market conditions, must be disclosed to investors. However, the activation threshold should not be disclosed.

- For *dual pricing*, the draft LMT RTS propose two options. The first option is to make use of two NAVs with the first NAV being used for subscriptions and based on the ask prices of the AIF's investments and the second NAV being used for redemptions and based on the bid prices of the AIF's investments. The second option is for one NAV under which subscriptions are based on the NAV plus an adjusted factor and redemptions are based on the NAV minus an adjusted factor.

- For *an anti-dilution levy*, this should be based on explicit and implicit estimated costs of portfolio transactions caused by subscriptions or redemptions. However, the AIF may choose to charge the exact transaction costs instead. The AIFM also has the option to only charge a fee if a pre-determined trigger threshold is exceeded.

- For *redemptions in kind*, although AIFMD II states that these are only to be used with professional investors, the draft LMT Guidelines appear to suggest that these could be selected by AIFs which have both professional and retail investors (although only used in respect of professional investors).

Many AIFMs will be keen to see if their existing LMTs would meet the criteria for the mandatory LMTs discussed above. Particular focus is expected to be on whether AIFs' current redemption programmes are likely to meet all the criteria for redemption gates.

In addition, the draft LMT RTS include details of the proposed features for the two LMTs to be used in exceptional circumstances: suspension of subscriptions, repurchases and redemptions and use of side pockets.

- For *suspension rights*, the draft LMT RTS state that suspension of subscriptions should apply simultaneously, and for the same period of time, as suspensions of repurchases and redemptions. However, this does not necessarily reflect current market practice where AIFMs may suspend redemptions but continue to accept subscriptions in certain circumstances.

- For *side pockets*, the draft LMT RTS envisage two types of side pocket either based on accounting segregation (i.e. a specific, dedicated share class) or physical segregation (i.e. a new, specific fund). Any side pocket would have to be closed-ended and managed with the sole objective of being liquidated.

The consultations closed on 8 October 2024 and the final LMT RTS are expected to be submitted to the European Commission for endorsement, and final LMT Guidelines published, by 16 April 2025.

Open-ended loan-originating AIFs

ESMA also issued a Consultation Paper on draft Regulatory Technical Standards on open-ended Loan Originating AIFs (**LOF RTS**). Under AIFMD II, a Loan Originating AIF must be closed-ended unless the AIFM can demonstrate to regulators that its liquidity risk management system is compatible with its investment strategy and redemption policy. The LOF RTS sets out the requirements that an AIFM must take into account in order to make that demonstration to its competent authority.

These include:

- An appropriate redemption policy taking into account factors such as the investor base, portfolio diversification and the length of the notice period.

- An appropriate proportion of liquid assets taking into account factors such as the redemption policy, the credit quality of loans to be granted and the expected cash flow.

- Liquidity stress tests which should usually be conducted at least quarterly.

- Ongoing monitoring of specific elements including of the level of liquid assets, expected cash flow and repayment of loans.

The consultation closes on **12 March 2025** with a final report expected by late 2025.

EU RETAIL INVESTMENT DIRECTIVE AND REGULATION – FUNDS ASPECTS

WHAT IS THIS? Proposed amendments to AIFMD, the UCITS Directive and the PRIIPs Regulation largely to introduce new enhanced investor protection requirements.

WHO DOES THIS APPLY TO? AIFMs, UCITS management companies and PRIIPs manufacturers and distributors. Not limited to retail funds.

WHEN DOES THIS APPLY? Not yet known.

The EU's Retail Investment Strategy, which includes changes to AIFMD, the UCITS Directive and the PRIIPs Regulation, continued to be negotiated during 2024 but no final agreement has been reached so far. Late in 2024, ESMA and the European Insurance and Occupational Pensions Authority wrote to the European Commission suggesting that proposals to improve the effectiveness of the EU capital markets be integrated into the Retail Investment Strategy. It is therefore currently unclear when the changes would start to apply - although this is likely to be 2026 at the earliest.

The Retail Investment Strategy includes a Retail Investment Directive with proposed amendments to AIFMD and the UCITS Directive. These include enhanced obligations on AIFMs and UCITS management companies not to charge "undue costs" including obligations to operate an effective pricing process and to reimburse the fund or investors for any undue costs charged. Costs borne by retail investors would have to be justified and proportionate. The negotiating draft from the Council of the European Union also includes a proposed "value for money" assessment.

A key point to note is that, despite its name, certain changes proposed under the Retail Investment Strategy are not just limited to funds with retail investors but would also apply in respect of professional investors. Therefore, the Retail Investment Strategy is also expected to be relevant for managers of professional investor funds such as private equity funds or venture capital funds.

The Retail Investment Strategy also includes a proposal for a Retail Investment Regulation amending the Regulation on Packaged Retail and Insurance-based Investment Products (**PRIIPs**) including changes to the contents and format of PRIIPS KIDs.

We discussed the proposals further in our 2024 New Year Briefing: **Financial Services Regulation 2024 - New Year briefing | Travers Smith**.

EU REGULATION ON INVESTMENT FUND STATISTICS

WHAT IS THIS? Additional information to be reported by Euro-zone investment funds to their national central banks.

WHO DOES THIS APPLY TO? Investment funds established in the Euro-zone (but not money market funds or pension funds).

WHEN DOES THIS APPLY? 1 December 2025.

The European Central Bank (**ECB**) issued an updated regulation on the information to be reported by Euro-zone investment funds to their national central banks (**NCB**): Regulation (EU) 2024/1988 concerning statistics on investment funds.

Currently, certain investment funds established in the Euro-zone are required to report statistical information to their NCB on their financial activities. In order to support its monetary and financial analysis, the ECB will require additional and more granular information to be reported as well as more frequent reporting.

The definition of investment fund in the regulation is broad and is not limited to entities which fall within the AIFMD or UCITS regimes but also other types of collective investment undertaking (although money market funds and pension funds are excluded). However, the greatest impact of the requirements is likely to fall on AIFs and UCITS established in Luxembourg and Ireland.

The additional requirements will include:

- More frequent reporting with information to be reported monthly rather than quarterly in many cases and enhanced security-by-security reporting in certain cases.

- Reporting of information on the monthly income received and dividends paid for each share class as well as annual fees paid by shareholders to the investment fund.

- Reporting of information on the classification of investment funds, for example, investment policy, geographical focus and SFDR compliance.

- Reporting of information on the residency and institutional sector breakdown of shareholders in the investment fund.

- Reporting of additional, more granular information including a more detailed breakdown of types of counterparties, relevant jurisdictions and categories of assets.

There are some potential derogations allowing for less frequent or aggregated reporting including for certain small investment funds and non-UCITS funds which value their assets less frequently than monthly.

The new requirements will take effect from **1 December 2025**. Affected investment funds will need to consider what changes will be needed to their processes to ensure that they will be able to collect and report the relevant information.

EU CONSULTATION ON MACROPRUDENTIAL POLICIES FOR NBFI

WHAT IS THIS? A consultation seeking views on the EU macroprudential supervisory framework for NBFI.

WHO DOES THIS APPLY TO? It is aimed at EU supervisors but the points raised will be of interest to NBFI – particularly managers of money market funds and open-ended funds.

WHEN DOES THIS APPLY? Not yet known.

The European Commission issued a consultation seeking views on the macroprudential supervisory framework for NBFI such as funds, asset management companies, pension funds and non-bank investment firms: Targeted consultation on assessing the adequacy of macroprudential policies for non-bank financial intermediation.

Concerns around the impact of NBFI on financial stability have been raised over the past few years by international bodies such as the Financial Stability Board and the International Organisation of Securities Commissions as well as national regulators including the Bank of England. Regulatory bodies are now starting to discuss and propose measures to address those concerns with the European Commission's consultation representing a key step at EU level.

The European Commission's consultation identified three key vulnerabilities from NBFI: unmitigated liquidity mismatches; the build-up of excessive leverage; and interconnectedness among NBFI sectors and NBFI and banks.

In order to address these vulnerabilities, the European Commission is seeking feedback on possible measures to be taken with a particular focus on open-ended funds (**OEFs**) and MMFs.

For OEFs, the consultation suggests that more could be done to identify liquidity stresses in a timely manner and to monitor liquidity risk at systemic level. This could include national competent authorities (**NCAs**) using collected data and reporting to identify inconsistencies between the liquidity profile of an investment fund and the use of specific LMTs with the ability to ask for remedial actions where needed. In addition, NCAs or ESMA could have the power to require an asset management company, for financial stability reasons and where certain conditions are met, to select a specific LMT for an OEF, even if not previously selected by the manager. There are also questions on leverage, showing that despite the AIFMD II reforms, this remains an area of concern.

An Enhanced Coordination Mechanism could also be created with a list of national macroprudential measures (**NMMs**) that are applicable to some or all OEFs. It appears that NCAs could be expected in some cases to adopt certain NMMs if they have not done so already.

Another suggestion is for ESMA to be given specific coordination powers over large asset management companies, with the day-to-day support and supervision left to NCAs under ESMA guidance. NCAs would remain responsible for the supervision of investment funds but would need the opinion of ESMA prior to the adoption of certain decisions and explain any deviation therefrom.

For MMFs, the consultation suggests that further consultation is needed on enhancing supervision, the stress testing framework and reporting requirements as well as the current definition of MMF. There is also a focus on measures to mitigate systemic risk and ensure market stability including improved reporting. Other possibilities suggested include an EU-wide stress test on MMFs and an EU ban on a reverse distribution mechanism.

More generally, the consultation discusses a number of measures which would be co-ordinated at EU level which would allow greater visibility of potential issues and the ability to co-ordinate action in a crisis. These could include a system-wide EU stress test across NBFI sectors and between NBFI and banks.

The consultation closed on 22 November 2024

EU UCITS ELIGIBLE ASSETS DIRECTIVE

WHAT IS THIS? Call for evidence on possible changes to the eligible assets for UCITS

WHO DOES THIS APPLY TO? EU UCITS and their managers.

WHEN DOES THIS APPLY? Not yet known.

ESMA issued a Call for Evidence on the review of the UCITS Eligible Assets Directive which sought views on possible changes to the eligible assets for UCITS.

The areas on which ESMA sought views included:

- The impact of removing the presumption that financial instruments which are traded on a regulated markets meet the criteria of liquidity and negotiability for being a "transferable security".
- Whether UCITS should be able to hold currency for investment purposes or just for liquidity purposes.
- The treatment of instruments (such as delta-one instruments) which might allow indirect exposures to ineligible assets.
- Which assets (from an expanded list) should be eligible for direct or indirect investment. Although the suggested list includes crypto assets, it is understood that ESMA is not fully supportive of their inclusion as eligible assets.

The closing date for comments was 7 August 2024.

EU EUROPEAN LONG-TERM INVESTMENT FUND REGULATION RTS

WHAT IS THIS? Regulatory technical standards supplementing the ELTIF Regulation.

WHO DOES THIS APPLY TO? European Long-Term Investment Funds and their managers.

WHEN DOES THIS APPLY? 26 October 2024.

ELTIF 2.0, which amended the 2015 European Long-Term Investment Fund Regulation (**ELTIF Regulation**), came into force on 10 January 2024. This included a number of changes aimed at making the European Long-Term Investment Fund (**ELTIF**) more attractive including facilitating certain ELTIF funds of funds, certain master-feeder structures, real estate and fintech focused funds, and prudent borrowing.

On 26 October 2024, Commission Delegated Regulation (EU) 2024/2759 with regulatory technical standards supplementing the ELTIF Regulation took effect. These include rules for when derivatives will be used solely for hedging the risks inherent to other investments of the ELTIF, the requirements for an ELTIF's redemption policy and liquidity management tools, rules for the matching of transfer requests of units or shares of the ELTIF, certain criteria for the disposal of ELTIF assets and certain elements of the costs disclosure.

UK AIFMD REVIEW

WHAT IS THIS? Review of the UK version of AIFMD.

WHO DOES THIS APPLY TO? UK AIFMs but some proposals may also be of interest to investors.

WHEN DOES THIS APPLY? Not yet known.

We discussed the proposed review of UK AIFMD in the our 2024 New Year Briefing (**Financial Services Regulation 2024 - New Year briefing | Travers Smith**) following the FCA's statement that it intended to start to consult in 2024. That consultation has not yet materialised and no further details have been provided although HM Treasury's Call for Evidence on the Financial Services Growth and Competitiveness Strategy stated that it would simplify regulation "*in particular for Alternative Investment Managers*".

It was previously thought that any amendments would focus on the distinction between full-scope, small authorised and small registered AIFMs and restrictions on the activities of full-scope AIFMs with a possible easing of the regulatory reporting requirements in a second phase. It is not clear if that is still the case or if other changes will now be prioritised.

UK RETAIL DISCLOSURE REGIME

WHAT IS THIS? A new UK retail disclosure regime.

WHO DOES THIS APPLY TO? Persons manufacturing or distributing certain retail products including managers of UK retail funds such as PRIIPs and UCITS.

WHEN DOES THIS APPLY? Expected H1 2025.

The Consumer Composite Investments (Designated Activities) Regulations 2024 were made in November 2024. These set out the legislative framework for the new UK retail disclosure regime. The more detailed rules will be in the FCA rules.

Consumer Composite Investments

The new regime will apply in respect of the new UK financial instrument of Consumer Composite Investment (**CCI**) which will replace the current EU-derived concept of PRIIPs and will also include UCITS and non-UCITS retail schemes. The UK PRIIPs Regulation and related legislation will be repealed.

As an interim measure, to reflect concerns around the regulatory treatment of investment trusts, the government made regulations exempting closed–ended UK-listed investment companies from the UK PRIIPs Regulation and certain provisions of the MIFID Organisational Regulation: The Packaged Retail and Insurance-based Investment Products (Retail Disclosure) (Amendment) Regulations 2024. However, investment trusts will be included in the new UK retail disclosure regime.

For these purposes, a CCI is defined as "*(a) an investment, (b) a contract of insurance, or (c) any right to or interest in anything listed in sub-paragraphs (a) or (b), where the value or amount payable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the investor*".

A number of exclusions will apply which largely reflect the current exclusions under PRIIPs but redrafted to fit the UK context. The key changes to the exclusions are the ability for the FCA to exclude certain debt securities from scope; no exclusion for contracts of general insurance; and a higher maximum consideration of £64 million for the exclusion for continuous issuances of debt securities by a credit institution. It remains to be seen what effect these differences will have in practice.

Persons carrying certain activities relating to CCI involving a retail investor (broadly anyone who is not a MiFID professional client) will be carrying on a designated activity and will need to comply with the relevant rules to be made by the FCA. As those activities will be designated activities, the rules will apply to unauthorised persons as well as authorised firms.

The relevant activities are:

- *Manufacturing a CCI*: This includes creating, developing, designing, issuing, managing, operating or carrying out a CCI or making changes to a term, condition or feature of a CCI. A person will be carrying on this activity where the CCI is to be made available to a retail investor in the UK.

- *Advising on a CCI:* This includes giving advice on the merits of buying, selling, subscribing for, exchanging, holding or redeeming a CCI; exercising, or not exercising rights conferred by a CCI; and/or entering into an agreement relating to a CCI. It applies where the advice is given to a retail investor in the UK or its agent.

- *Offering a CCI:* This means communicating sufficient information on the CCI and the terms on which it is offered to enable a person to decide to buy, subscribe for or enter into an agreement relating to the CCI. It applies where the CCI is offered to a retail investor in the UK.

- *Selling a CCI:* This includes disposing of the CCI for valuable consideration and is carried on where the CCI is sold to a retail investor in the UK. For these purposes "disposing" includes:

- in the case of a CCI consisting of rights under a contract, surrendering, assigning or converting those rights or assuming the corresponding liabilities under the contract;
- in the case of a CCI consisting of rights under other arrangements, assuming the corresponding liabilities under the arrangements; and
- in the case of any other CCI, granting the rights or interests of which it consists.

The FCA will have the power to give directions to persons carrying on a CCI designated activity. Retail investors who suffer a loss as a result of a breach of a CCI designated activity rule will also have a right of action.

Some temporary exemptions will apply for managers of UK and EEA UCITS and UK NURS until 31 December 2026.

The exemptions in the FSMA 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 and the FSMA 2000 (Financial Promotion) Order 2005 for PRIIPs KIDs have been deleted and there is no replacement in the CCI Regulations. As a result, there are no statutory exemptions for financial promotions which comply with the new UK retail disclosure regime. It is not yet clear whether equivalent exemptions will be included in the forthcoming FCA rules.

FCA product information rules on CCI

In December 2024, the FCA issued CP24/30: A new product information framework for Consumer Composite Investments which set out its proposed rules for manufacturers and distributors of CCI.

In CP24/30, the FCA confirms some of the main products that would be considered CCI. These include funds, derivatives, structured products and certain other complex financial instruments. The FCA also confirmed that the regime would apply to non-UK firms promoting products to UK retail investors, including through the new UK Overseas Funds Regime.

The proposed new regime would include rules for both manufacturers and distributors of CCI. The intention of the new regime is to ensure a less prescriptive, more user-friendly approach with manufacturers and distributors expected to work together to achieve this. The draft FCA rules therefore include an obligation for manufacturers and distributors to co-operate and share information on a timely basis.

Under the proposed FCA rules, the manufacturer would have to produce a product summary which, unlike the current requirements, could be largely designed by the manufacturer subject to some mandatory core information disclosures. These core information disclosures include:

- *General product information*: This includes the name and unique product identifier of the CCI; information about the characteristics of the CCI including its investment objectives and strategy; information on the availability of redress; the investment term or recommended holding period (if relevant); exit fees; and maturity date. Where the CCI is a fund unit, additional information is required including its authorisation status and the name of the operator or AIFM.
- *Information on costs and charges:* This would be based on a detailed methodology set by the FCA. Broadly, firms would have to disclose all direct and indirect costs and charges associated with a product including ongoing, one-off and transaction costs. Firms would need to provide a summary cost

illustration showing product costs over a single holding period including entry costs, exit costs, ongoing costs and transaction costs as both a percentage and also a cash amount over a 12-month period. Performance fees and carried interest would be disclosed as an explanation of how the fee is structured together with a practical example.

- *Information on risk*: Risk would be disclosed on a more granular scale of 1-10 with the FCA rules setting out how this should be calculated. This would be accompanied by a narrative risk description including factors which could potentially affect the risk profile and performance of the product. CCI which the FCA considers as high risk (including highly leveraged products, derivatives, securities issued by venture capital trusts and products with low liquidity) should always be a 9 or 10 on the risk scale.

- *Information on performance*: Past performance data should be disclosed on a standardised line graph covering a 10-year period (or for as long as the data is available) and based on an initial investment of £10,000. Specific requirements apply where less than 12 months of data is available and for certain types of product. In some cases, benchmark information should also be provided.

The product summary and certain other relevant information would have to be provided to the distributor along with a machine-readable version of the core information disclosures. The information could generally be disclosed on the manufacturer's website and should be kept up to date with a review at least once a year.

Distributors could then either use the manufacturer's product summary when distributing the CCI (which could include additional product information to support investor understanding) or produce their own, consumer-facing product summary. The distributor's product summary would need to ensure that the proposed retail investors have sufficient understanding of the CCI.

Both the manufacturer and the distributors would also need to make sure that they comply with any Consumer Duty obligations which may require additional information to be provided or additional steps to be taken.

The product summary would have to be provided to potential retail investors early in the investment process. The product summary would also have to be provided to investors in a durable medium at the point of sale or very shortly after.

The obligations above would also apply to non-authorised firms in respect of their CCI activities. However, the FCA has also imposed some additional obligations, most of which reflect obligations which already apply to authorised firms. These include obligations reflecting some of the FCA's Principles for Businesses, such as acting with integrity; acting with due, skill care and diligence; having appropriate systems and controls; protection of client assets and notifying the FCA of relevant matters (reflecting the Principle 11 notification). Product governance requirements would also apply to non-authorised manufacturers including a product approval process, risk assessment and distribution strategy.

In certain cases, the manufacturer may not have full control over the distribution of its non-retail products. For example, listed securities which are intended exclusively for non-retail investors and which are sold on the secondary market. The FCA proposes disapplying its requirements where an offer of a CCI, which is a readily realisable security, meets certain criteria including that the minimum investment is £50,000, the marketing materials make it clear that the product is not intended for retail investors and the issuer (or distributor for secondary markets offers) has taken reasonable steps to ensure that the offer and related communications are only directed at non-retail investors.

The consultation closes on 20 March 2025 with the FCA is planning to issue a Policy Statement with final rules during 2025. An 18-month transition period is proposed. There will also be a further consultation on consequential changes to other parts of the FCA's Handbook in early 2025.

UK OVERSEAS FUNDS REGIME

WHAT IS THIS? New regime for non-UK funds to market to retail investors in the UK.

WHO DOES THIS APPLY TO? Managers of non-UK funds but currently only relevant for EEA UCITS (other than MMFs).

WHEN DOES THIS APPLY? 31 July 2024 with EEA UCITS schemes able to apply for recognition from 30 September 2024 on the basis of designated "landing slots".

The FCA's new rules on the Overseas Funds Regime (**OFR**) came into force on 31 July 2024. Under the OFR, collective investment schemes based in jurisdictions deemed to be "equivalent" will be able to apply for recognition of that scheme from the FCA in order to market to retail investors in the UK.

The final rules were set out in PS24/7: Implementing the Overseas Funds Regime: Feedback to CP23/26 and final rules. A further consultation is expected on whether the UK SDR and labelling regime should be extended to OFR funds.

To date, only EEA UCITS (other than MMFs) have been recognised as equivalent by the UK government. However, it is expected that additional jurisdictions will be recognised in due course.

New EEA UCITS schemes, i.e. those not in the Temporary Marketing Permissions Regime (**TMPR**), have been able to apply for recognition from 30 September 2024. EEA UCITS schemes in the TMPR have to apply during their "landing slot" with stand-alone schemes able to apply for recognition between 1 October 2024 and 31 December 2024 and landing slots for operators of umbrella UCITS running from 1 November 2024 in alphabetical order based on the fund operator's name. Operators of schemes in the TMPR must not apply for recognition until they receive a specific email from the FCA on how to apply and the period during which they should apply. Firms which miss their landing slot are removed from the TMPR and must reapply under the OFR. Further information on this can be found on the FCA's dedicated webpage: Overseas Funds Regime: Update for firms | FCA.

Applications to the FCA under the OFR must include specified information and the scheme operator must comply with many of the prospectus requirements for UK authorised funds set out in the FCA's Collective Investment Schemes handbook (COLL). Information on complaints and compensation arrangements must also be provided. The FCA issued example disclosures for OFR recognised schemes to comply with the requirements regarding consumer redress schemes.

Financial promotions relating to the OFR recognised scheme will need to be approved, unless the promotion benefits from an exemption under the Financial Promotion Order.

The scheme operator must also notify the FCA of certain rule breaches and certain changes to the fund or events affecting the fund including any change of name or address of the operator, trustee/depositary or UK representative or change to the fund's name. The FCA may also require the scheme operator to provide certain other information as set out in PS24/7. These include fundamental changes to the investment objective, policy or strategy; changes to the target UK investors; and matters that would be likely to cause a significant negative effect on UK investors at fund or class level. These must be notified to the FCA as soon as reasonably practicable. If the operator seeks withdrawal of recognition as an OFR recognised scheme, UK investors should be given adequate written notice before the request is to take effect.

Scheme operators will also need to have facilities available in the UK to enable investors to access key documents relating to the scheme, obtain the latest prices of units, submit orders to subscribe for or redeem units, obtain or provide certain other information and submit complaints. These can be provided electronically as long as, among other things, the prospectus envisages interactions taking place via electronic media and all unitholders have consented to such arrangements. Otherwise, a physical presence in the UK will be required. Scheme operators will need to consider whether accepting orders to subscribe for or redeem units would be regulated activities requiring FCA authorisation. Operators will also need to notify an address for service to the FCA.

In September 2024, the FCA issued a guidance note setting out its approach to recognition of funds under the OFR and details of how the process will work: The FCA's approach to recognition of funds under the Overseas Funds Regime. It also included examples of the types of funds that it is unlikely to recognise such as:

- Funds with unsuitable, duplicative or misleading names.
- Funds investing in, or with economic exposure to, cannabis-related investments, crypto-currency or contingent convertible bonds.
- Funds with permanent redemption/exit charges or inappropriate charging structures.
- Funds without segregation of liability between sub-funds or where unitholders' liability to pay is not limited.
- Funds with inappropriate liquidity management tools.

UK RESERVED INVESTOR FUND

WHAT IS THIS? New type of tax efficient fund.

WHO DOES THIS APPLY TO? Fund operators.

WHEN DOES THIS APPLY? Not yet known.

In the Autumn 2024 Budget, HM Treasury confirmed that it would proceed with the introduction of a new type of tax-efficient fund. This will be known as the Reserved Investor Fund (Contractual Scheme) (**RIF**) and will be an unauthorised co-ownership AIF.

The full details of the RIF are not yet known. More details, including in respect of its tax treatment, are expected in the coming months. Based on previous proposals, it seems likely that it will be limited to professional investors and investors investing a minimum of £1 million.

Some concerns have been raised by industry associations around the requirement for the RIF to be structured as an AIF as this could exclude certain investment structures. It is possible that this may be revisited in the future.

The RIF is expected to be particularly attractive for investment in commercial real estate and, for the right investors, could be a viable alternative to the Jersey property unit trust.

CONDITIONAL 'UNBUNDLING': INVESTMENT RESEARCH PAYMENT OPTIONALITY FOR FUND MANAGERS

WHAT IS THIS? FCA consultation on extending to pooled fund managers the additional option – currently in place for MiFID investment firms (see below) – as to how to pay for investment research without it constituting an inducement, with some modifications to reflect the nature of pooled vehicle management.

WHO DOES THIS APPLY TO? Full scope UK AIFMs, small authorised UK AIFMs, UCITS management companies and residual CIS operators.

WHEN DOES THIS APPLY? The consultation was only open for six weeks and closed on 16 December 2024. In the policy statement, the FCA said that, if it decides to proceed (which it almost certainly will), it will aim to publish rules or guidance in a policy statement in the first half of 2025. Presumably the new rules would come into force immediately, or shortly thereafter.

In July 2024, following a consultation in April 2024, the FCA finalised its rules on a new option by which MiFID investment firms may pay for investment research: broadly, the new option – which is additional to the pre-existing choice of either paying for research out of the firm's own resources (**the P&L model**) or agreeing separate research payment accounts with their clients (**the RPA model**) – allows MiFID investment firms to use joint payments for third-party research and execution services (i.e. on a "bundled" basis), subject to complying with detailed rules on budgets for research spending, cost allocation, value assessment and disclosure requirements (which the FCA refers to collectively as "guardrails") (PS24/9: Payment optionality for investment research).

The new rules (consisting of amendments to COBS 2.3A and COBS 2.3B) came into effect on 1 August 2024. At the time, amendments were also made to COBS 18 Annex 1R (Research and inducements for collective portfolio managers) to make it clear that the new payment option rules did *not* apply to collective portfolio managers and should therefore be disregarded in that context. However, the FCA stated that its policy intention was to ensure consistency across all the rules on research and inducements for investment firms and collective portfolio managers and therefore would be consulting on extending the payment option to fund managers.

That consultation, CP24/21: Investment research payment optionality for fund managers was published on 5 November 2024. Essentially, in keeping with the regulator's policy intent, the consultation proposes to extend the availability of the "bundled" payment option to collective portfolio managers on substantially the same terms as those that apply to MiFID investment firms, but with some technical modifications to reflect the fact that assets of a fund are held on a pooled, not segregated, basis and are managed collectively.

Consultation closed on 16 December 2024. If the FCA chooses to proceed with the extension (which is likely) it aims to publish any finalised rules or guidance in a policy statement in **H1 2025**. The rules will likely be effective immediately.

The new payment option

COBS 2.3B3R will apply to collective portfolio managers when executing orders or placing orders with other entities for execution in relation to financial instruments for or on behalf of their funds. The rule will allow such managers to receive third-party research in return for joint payments for such research together with execution services subject to complying with modified "guardrails" (those modifications will adopt the same approach applied to COBS 18 Annex 1R modifications to the RPA model rules).

The "guardrails" – adapted for fund managers

As with the new payment option for MiFID firms, the imposition of what the FCA refers to as "guardrails" – a set of compliance obligations almost as onerous as those which apply to the operation of research payment accounts – will likely be decisive in determining whether managers will want to make the move to a different *modus operandi*. Many firms will want to think twice about the relative costs and benefits of adopting the extension, particularly if they have found a way of operating within the existing rules, whether by way of RPAs or otherwise. In summary, the adapted "guardrails" are as follows:

- *A written policy on joint payments*: the fund manager must have a written policy on joint payments for each fund it manages that describes the firm's approach to joint payments and explains how the firm's governance, decision-making and controls in respect of third-party research purchased using joint payments operate – this should include how these are maintained separately from those for trade execution.

- *The methodology for research cost calculation and identification*: fund managers would be required to stipulate the methodology for how the research costs will be calculated and identified separately within the total charges for such joint payments.

- *A research provider payment allocation structure*: fund managers will be required to establish a research provider payment allocation structure for the allocation of payments between different research providers, including:

    - Third-party providers of research and execution services – i.e. those providing bundled services

    - Research providers not engaged in execution services and not part of a financial services group that include an investment firm which offers execution or brokerage services – i.e. those not providing bundled services

- *Responsibility for administering etc.*: the fund manager must, for each fund it manages, be fully responsible for:

- The administration of accounts for purchasing research from joint payments
- Ensuring timely reconciliation and reporting of the joint payment account with an appropriate frequency

- *Budget*: as with MiFID firms, the fund manager must set a budget at least annually for *each fund it manages* based on the expected amount of third-party research; this is likely to be controversial for fund managers. That budget must be based on the expected amount needed for third-party research relating to financial instruments in respect of which the firm is executing orders, or placing orders with other entities for execution, for or on behalf of the fund – and it must not be linked to expected volumes or values of transactions executed on behalf the fund.

  If the cost of research increases or exceeds the research budget for the relevant fund, fund managers must:

  - inform the governing body of the fund (if it is independent of the firm);
  - assess whether the higher cost would be in the interests of the fund and its investors or unitholders;
  - make sure that (where applicable) the increase in research charges is assessed as part of the assessment of value under COLL (COLL 6.6.20R) or the value assessment under the Consumer Duty (PRIN 2A.4); and
  - make specified disclosures in the annual report, periodic statement or fund prospectus, depending on what type of fund the firm is managing.

- *Fair allocation*: in relation to a fund, the fund manager must allocate fairly the costs of research using joint payments, taking into consideration the budget set at the level of each fund.

- *Periodic value assessment*: in relation to an unauthorised AIF or an unregulated collective investment scheme, the fund manager must periodically (and at least annually):

  - Assess the value, quality and use of research purchased using joint payments and their contribution to the investment decision-making process.
  - Ensure that the amount of research charges to clients is reasonable compared with those for comparable services.

  In the case of an authorised fund, the manager's value assessment for the purposes of this guardrail is part of the assessment of value required under the relevant chapter of COLL.

- *Prior disclosure*: the fund manager must provide appropriate disclosure of joint payments in fund documentation before a person becomes an investor or unitholder in a fund as follows:

  - The firm's use of joint payments for research in relation to the fund, including where relevant, how the use of joint payments is combined with the use of other permitted payments.

- The key features of the firm's policy on joint payments in relation to the fund – or the policy itself – having regard to the information needs of the fund's investors or unitholders. This information must be communicated to them in a way which is clear, fair and not misleading.

- The expected annual costs to the client, provided as part of *ex ante* disclosures on costs and charges.

- *Periodic disclosure*: the fund manager must provide disclosure of joint payments in fund documentation on a periodic basis – or on demand – as follows:

  - The most significant of either:

    - *Benefits and services received* from research providers (measured by total amounts paid); or

    - *Types* of research providers from which such services are purchased.

  - The total costs incurred by the client, disclosed on an annual basis, reflecting the total payments made for research purchased using joint payments over that period.

  In the case of an authorised fund, this disclosure must be made in the annual long report of the fund. A full-scope AIFM may wish to publish this information with the information required to be disclosed in the AIF annual report by FUND 3.3. A small authorised UK AIFM or a residual CIS operator may wish to provide this information in the periodic statement to unitholders or investors.

Additional requirements specific to authorised retail funds

Where the fund manager of an *authorised retail fund* decides to use the joint payment option, it will be required to do the following (put broadly):

- treat this as a significant change under the relevant COLL rules and guidance;

- inform unitholders of the new payment option at least 60 days before it is adopted; and

- seek FCA approval for making such a significant change to the fund;

- continue to meet ongoing costs and charges disclosure requirements in key investor information (KII);

- make an appropriate disclosure in the "objectives and investment policy" section of the KII document if joint payments materially increase the fund's transaction costs.

Other funds

Broadly, for funds other than authorised retail funds, there are no additional requirements or guidance over and above the rule changes outlined above. However, managers of Long-Term Asset Funds (LTAFs) which take up the joint payment option would have to comply with the relevant rule requirements, depending on whether the fund has been made available to retail investors who are not limited protection LTAF professionals. For unauthorised funds, while there are no specific additional requirements, the FCA will still expect the manager to act fairly in the interests of investors when deciding to take up the joint payment option, and in its operation.

REVIEW OF UK STEWARDSHIP CODE

WHAT IS THIS? Proposed changes to the Financial Reporting Council's 2020 UK Stewardship Code.

WHO DOES THIS APPLY TO? Signatories to the UK Stewardship Code.

WHEN DOES THIS APPLY? Expected to be 1 January 2026.

In late 2024, the Financial Reporting Council (**FRC**) published its UK Stewardship Code Consultation which proposed changes to the 2020 UK Stewardship Code to ensure it reflects developing stewardship practice and leads to high-quality disclosures but also does not impose onerous reporting obligations on signatories. The consultation is open until 19 February 2025.

Earlier in 2024, pending the consultation, the FRC issued an update with some interim changes for existing signatories aimed at reducing the reporting burden (and which are now more fully reflected in the consultation). These included not requiring certain reporting except where there are material changes, the ability to cross reference to certain existing disclosures and clarification of some reporting and engagement obligations. Existing signatories were permitted to apply these as of the 31 October 2024 reporting deadline.

The changes proposed by the FRC in the consultation include a revised definition of stewardship: *"Stewardship is the responsible allocation, management and oversight of capital to create long-term sustainable value for clients and beneficiaries".* This is accompanied by supporting language explaining how this should be interpreted. The FRC thinks that some signatories have been interpreting the current definition to mean that the primary purpose of stewardship is to pursue environmental and social objectives. One aim of the revised definition and supporting language is to clarify that it is for each signatory to determine its own specific investment objectives.

Under the proposals, the reporting process more generally has also been overhauled. The Principles are divided between two different reports with different reporting and assessment requirements applying to each report. The Principles have also been slightly reworked. The reports for asset owners and asset managers will be as follows:

- *Policy and Context Disclosure:* This includes the Principles related to:
    - The organisation, its clients and investment beliefs.
    - Governance and resources.
    - Stewardship policies and review.
    - Conflicts of interest.
    - Dialogue with clients and beneficiaries.

  This will need to be submitted annually but only updated as necessary by the signatory. It will be reviewed by the FRC on a three-yearly basis unless there are significant changes in the interim.

- *Activities and Outcomes Report:* This includes the Principles related to:
    - Integration of stewardship and investment.
    - Market-wide and systemic risks.
    - Engagement.
    - Exercising rights and responsibilities.
    - Selection and oversight of external managers.
    - Monitoring service providers.

  This disclosure will need to be submitted annually and will also be assessed by the FRC on an annual basis.

A similar structure will apply for service providers (proxy advisors and investment consultants).

In order to avoid reporting becoming a tick-box exercise, the Principles will include prompts on how to report and FRC proposes to develop guidance to supplement each Principle with suggestions for information that signatories may wish to include. The consultation includes sample guidance for the Principle related to engagement. If the FRC does goes ahead, it will issue guidance for all Principles without any further consultation.

The FRC also proposes allowing signatories to refer to external information as part of their assessment in order to avoid duplication, particularly with other reporting frameworks.

The updated Code is expected to be published in the first half of 2025 with an effective date of **1 January 2026**.

The Walker Guidelines for Disclosure and Transparency in Private Equity issued by the Private Equity Reporting Group were also updated in December 2024. We discuss this in more detail in our briefing: **Revised Walker Guidelines published | Travers Smith**.

LUXEMBOURG FUNDS REGIME – A ROUND-UP OF KEY DEVELOPMENTS

WHAT IS THIS? A round-up of CSSF initiatives in respect of investment funds.

WHO DOES THIS APPLY TO? Luxembourg investment fund managers managing UCITS and/or AIFs.

WHEN DOES THIS APPLY? Various.

In addition to the abovementioned EU developments which will impact Luxembourg and entities and individuals based in Luxembourg, we wanted to highlight the Luxembourg specific matters below.

Clarification on organisation requirements and conditions for authorisation

Circular CSSF 18/698 published by the Commission de Surveillance du Secteur Financier (**CSSF**) in 2018 is crucial for Luxembourg investment fund managers as it provides clarifications on certain conditions for authorisation. In particular, this includes the shareholding structure, the minimum own funds requirements, the administrative bodies, the arrangements concerning the central administration and governance and the rules governing the delegation framework.

It is expected that the CSSF will update this Circular in the course of 2025 to cover the most recent practices of the market and changes which will be brought by AIFMD II. The amendments to that Circular will have a real impact on Luxembourg investment fund managers requiring them to review and potentially update their internal policies and procedures.

Guidelines on errors

Circular CSSF 24/856 (which replaces Circular CSSF 02/77) sets out the guidelines to be followed by Luxembourg investment fund managers that operate in Luxembourg in the case of errors (e.g. wrong calculation of the NAV, non-compliance with the investment rules, incorrect application of the swing pricing mechanism, non-compliant payment of costs/fees, incorrect application of the cut-off rules and investment allocation errors) in the administration or management of undertakings for collective investment subject to the CSSF’s supervision.

The Circular incorporates the CSSF regulatory practice built up over time and entered into force on 1 January 2025.

Delegation of the portfolio management function by investment fund managers

In October 2024, the CSSF provided the market with feedback on its main findings and recommendations with the publication of the CSSF thematic review on the delegation of the portfolio management function by investment fund managers.

Among other things, the CSSF highlighted that Luxembourg investment fund managers should avoid any excessive reliance on delegates from the same group and should verify the organisation of the control functions within the delegates and reinforce their controls in case a “key person” risk exists at the level of the delegate, the delegate has limited resources or a weak “three lines of defence” organisation.

The CSSF invited all Luxembourg investment fund managers to perform, at the latest by the end of Q1 2025, a comprehensive assessment of how they monitor the delegation of their portfolio management function in the light of the observations mentioned in the thematic review document and of the applicable regulatory requirements. AIFMD II also contains provisions on delegation, and so firms will also need to factor these into their assessments.

Conflicts of interest

Conflicts of interest has always been a very important topic for the CSSF. We have heard that the CSSF will increase its focus on this matter in 2025. Therefore, Luxembourg investment fund managers are advised to review their conflicts of interest policy and make sure that their register of conflicts of interest is up to date.

IOSCO CONSULTATIONS ON LIQUIDITY RISK MANAGEMENT RECOMMENDATIONS AND GUIDANCE

WHAT IS THIS? Consultations on revised recommendations for liquidity risk management and related guidance.

WHO DOES THIS APPLY TO? Primarily managers of open-ended funds but some aspects may be relevant to managers of closed-ended funds.

WHEN DOES THIS APPLY? Not yet known.

The International Organization of Securities Commissions (**IOSCO**) has published consultations on Revised Recommendations for Liquidity Risk Management for Collective Investment Schemes and Guidance for Open-ended Funds for Effective Implementation of the Recommendations for Liquidity Risk Management.

The proposals in the consultations are intended to operationalise the FSB's Revised Policy Recommendations to Address Structural Vulnerabilities from Liquidity Mismatch in Open-Ended Funds which we discussed in the 2024 New Year briefing.

Proposed changes to the Recommendations include a categorisation approach; grouping open-ended funds according to the liquidity of their assets, with specific expectations as regards redemptions for each category; and promoting the greater use of anti-dilution liquidity management tools in normal and stressed market conditions.

The Guidance is aimed at supporting the implementation of the Recommendations with additional guidance on areas such as minimising structural liquidity mismatches in open-ended funds, the design and use of liquidity management tools, disclosures to investors and stress testing.

The consultations close on **11 February 2025**.

4 MIFID II AND INVESTMENT FIRMS

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
3 January 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – Consolidated Tape Providers	ESMA launches the selection procedure for the CTP for bonds
17 January 2025	MiFIR Review – ESMA consultation on review of RTS 22 and RTS 24	ESMA consultation closes (extended from 3 January 2025)
28 January 2025	EU Listing Act amendments to MiFID II research provisions – ESMA consultation	ESMA consultation closes
31 January 2025	UK bond consolidated tape provider	Date by which the FCA intends to publish draft tender documents on its procurement portal (Atamis)
January 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – derivatives and packages transparency and reporting obligations for CTPs	ESMA expected to launch a consultation on derivatives and packages transparency and reporting obligations for CTPs
3 February 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – the new DPE regime	The DPE regime for post-trade transparency become fully operational

28 February 2025	FCA consultation on MiFID Org Regulation	Consultation closes
28 March 2025	FCA discussion chapter on future amendments to EU derived organisational and conduct rules	Deadline for comments
March 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – ITS/RTS	ESMA is expected to publish a final report including a new ITS on systematic internaliser notification, amendments to RTS 3 on the volume cap and a recast of RTS 7 containing new requirements on circuit breakers and targeted amendments to adapt the DORA framework
March 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – transaction reporting and order book record keeping	ESMA is expected to publish a final report on transaction reporting and order book record keeping
June 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – Consolidated Tape Providers	ESMA to launch the selection procedure for the CTP for shares and ETPs
Q2 2025	EU Listing Act amendments to MiFID II research provisions – ESMA final report	ESMA expects to publish final report containing technical advice to the Commission on the amendments to the MiFID II Delegated Directive on investment research
Early July 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – Consolidated Tape Providers	ESMA intends to adopt a reasoned decision on the selected applicant for the CTP for bonds
29 September 2025	MiFIR amending Regulation (MiFID II/MiFIR Review)	Date on which ESMA is required to start publishing trading data and monitoring trading subject to the single volume cap – therefore the date on which the single volume cap effectively replaces the double volume cap

29 September 2025	MiFID II amending Directive (MiFID II/MiFIR Review)	Deadline by which Member States must transpose the amending Directive
October 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – derivatives and packages transparency and reporting obligations for CTPs	ESMA expected to publish its final report on derivatives and packages transparency and reporting obligations for CTPs
1 December 2025	UK MiFID II/MiFIR – FCA bond transparency regime	Date on which the FCA's bond transparency regime rule changes take effect (the bond consolidated tape provider is not required to become live and start operating before that date)
End 2025	MiFIR amending Regulation (MiFID II/MiFIR Review) – Consolidated Tape Providers	ESMA aims to adopt a reasoned decision on the selected applicant for the CTP for shares and ETFs
30 June 2026	MiFIR amending Regulation (MiFID II/MiFIR Review) – payment for order flow (PFOF)	The date by which (where Member States have allowed firms to continue a pre-existing practice of PFOF in their jurisdiction by way of temporary exception to the ban) the practice must be phased out.
2026	EU Retail Investment Strategy	Possible date for changes to start to apply

ITEMS COVERED IN THIS SECTION

THE MiFID II/MiFIR REVIEW: AMENDING LEGISLATION

WHAT IS THIS? Ongoing work following the set of amendments to the MiFID II regime which were focused on enhancements to the market access and data transparency provisions.

WHO DOES THIS APPLY TO? Market users, providers and operators.

WHEN DOES THIS APPLY? The Regulation applied on 28 March 2024 (but is subject to a transition provision which will suspend the operation of some of the key requirements that are dependent on delegated regulations to be effective, until a specified time after the relevant regulations are in force). The amending Directive must be transposed by Member States by 29 September 2025. ESMA is subject to a number of different deadlines as regards submission to the Commission of the various draft technical standards (see below).

The amending legislation

On 8 March 2024, two amending acts resulting from the process commonly referred to as the "MiFID II/MiFIR review" were published in the Official Journal of the EU:

- Directive (EU) 2024/790 amending MiFID II.
- Regulation (EU) 2024/791 amending MiFIR as regards enhancing data transparency, removing obstacles to the emergence of consolidated tapes, optimising the trading obligations and prohibiting payment for order flow.

The review was aimed at providing investors with better access to market data (particularly as regards the provision of consolidated market data) and enhancing the global competitiveness of the EU capital markets. This included addressing aspects of the MiFID II regime that had not worked as originally intended – for instance, the technical details of the market transparency and waiver provisions had proved to be overcomplicated. Both acts entered into force on 28 March 2024. The **Regulation applied immediately** in all Member States on 28 March 2024 (subject to some phasing of requirements). Member States will have 18 months in which to transpose the **amending Directive** – i.e. until **29 September 2025**.

Transition

As noted above, the amending Regulation came into force on 28 March 2024, with certain elements of the Regulation phasing in over time. Although several key provisions, read in isolation, appear to be effective with immediate effect, many of them are in practice reliant upon new, or amended, supplemental Commission delegated regulations being in place for them to become fully operational and effective.

In this respect, these MiFIR provisions need to be read in conjunction with the MiFIR amending Regulation's transition provision. Article 54(3) MiFIR (as added) provides that the provisions of the delegated acts adopted by MiFIR before 28 March 2024 shall continue to apply until the date of application of new delegated acts adopted under MiFIR as amended. This means that, in a number of cases, despite the MiFIR changes, the existing delegated regulations, together with the pre-28 March 2024 MiFIR provisions that they supplement, will continue to apply until such time as the new or amended delegated regulations are in place. It also means that, some changes to MiFIR (which ESMA refers to as "self-executing" – i.e. that are not reliant on any changes to delegated regulations to be effective) came into effect on 28 March 2024.

This caused a certain amount of confusion amongst stakeholders, so much so that ESMA was moved to issue a communication on 21 March 2024 and a more detailed public statement on 27 March 2024 and the European Commission publishing an interpretative notice (published in final form in the Official Journal on 2 May 2024).

The changes in outline

Of the two acts, the Regulation amending MiFIR contains the bulk of the substantive changes, with the much shorter Directive amending MiFID II being largely restricted to only a handful of consequential amendments.

We covered the key changes (at provisional political agreement stage) in some detail in our **New Year Briefing 2024**. In outline, those changes (taking into account the transition provision, where relevant) include:

- *Consolidated market data*: the establishment of EU-level "consolidated tapes" or centralised data feeds. See below for further information on the establishment of consolidated tape providers (CTPs).

- *Ban on payment for order flow*: the imposition of a general ban on payment for order flow (**PFOF**), whereby brokers receive payments for forwarding client orders to certain trading platforms. By default, this ban became effective on **28 March 2024**. However, *where PFOF had existed in a Member State prior to 28 March 2024*, competent authorities are permitted (but not required) to allow firms in their jurisdiction to be exempt from the ban, provided that PFOF is only provided to clients in that Member State and provided the practice is temporary and is fully phased out by **30 June 2026**.

- *The double volume cap becomes a single volume cap*: the double volume cap mechanism – under which the reference price and negotiated price equity waivers are disapplied – is to be simplified. In future, it will no longer be accurate to refer to it as a double volume cap. Instead of the 4%/8% mechanism, trading venues will be required to suspend their use of the equity reference price waiver where the percentage of trading in a financial instrument in the EU carried out under that waiver exceeds a single volume cap – 7% of the total volume of trading across the EU. Trading venues must base their decision to suspend use of the waiver on data published by ESMA; the publication of such trading data by ESMA (and the monitoring of the trading subject to the new single volume cap) starts on **29 September 2025**. This is therefore the date on which the single volume cap will effectively replace the double volume cap. For the time being, therefore, the double volume cap remains in place and the rules, as specified in RTS 3, continue to apply. Incidentally, there will be no changes to the ESMA opinions on pre-trade transparency waivers: once the single volume cap applies, negotiated trade waivers of liquid instruments (type 1) will no longer be subject to the cap.

- *Non-equity transparency – trading systems in scope of the transparency regime*: the amendments to MiFIR shrink the scope of the non-equity transparency regime. In particular, they limit the scope of pre-trade transparency to central limit order book and periodic trading auctions. As of **28 March 2024**, the provisions on pre-trade transparency ceased to apply to Request for Quote (**RFQ**) and voice trading systems. The provisions specifying the characteristics of trading systems *other than RFQ and voice trading*, as currently set out in RTS 2, will continue to apply until an amended RTS 2 applies.

- *Non-equity transparency – pre-trade waivers*: MiFIR, as amended, ushered in significant changes to the provisions on pre-trade transparency for non-equity transactions. These included the removal of the size specific to the financial instrument (**SSTI**) waiver: market operators and investment firms were therefore no longer able to make use of the SSTI waiver as from **28 March 2024**. In addition, as from the same date, the provisions on pre-trade transparency ceased to apply to RFQ and voice trading systems (see previous bullet point) and out-of-scope derivatives (see below)

- *Non-equity deferred publication – large in scale*: Competent authorities will no longer have the broad discretion to authorise the deferred publication by market operators and investment firms of "large in scale" transactions in non-equity instruments (although they will retain the ability to defer publication of transactions in sovereign debt instruments). Broadly, the deferred publication arrangements will be subject to size categories determined by ESMA (with different categories for bonds, structured finance products or emission allowances and sovereign bonds). Deferred publication of derivatives will also be subject to objectively-determined size criteria. In accordance with the transition provision referred to above, the current deferral regime set out in RTS 2 (and therefore the regime specified in the pre-28 March 2024 Level 1 regime) will continue to apply until the revised RTS applies. Competent authorities can therefore continue to authorise deferrals under the existing regime until that date.

- *Non-equity transparency – scope of the pre-trade transparency regime for trading venues in respect of derivatives*: MiFIR, as amended, limits the scope of the transparency regime for derivatives to exchange-traded derivatives and a relatively narrow subset of OTC derivatives (that are denominated in euro, Japanese yen, US dollars or pounds sterling and which are (broadly): centrally cleared under the EMIR clearing obligation (and, in the case of interest rate derivatives, of one of 11 tenors), or are centrally cleared single-name credit default swaps referencing a global systemically important bank or an index comprising such a bank). In this case, market participants were expected to apply the new scope of the transparency regime for derivatives (as set out in the amended MiFIR) as from **28 March 2024** (relevant provisions in RTS 2 ceased to apply to out-of-scope derivatives).

- *Making pre-trade data and post-trade data available on a reasonably commercial basis*: Market operators and investment firms operating a trading venue are currently required to make pre-trade and post-trade data available to the public on a reasonable commercial basis and ensure non-discriminatory access to the information. In any event, such information must be made available free of charge 15 minutes after publication. This obligation will be expanded to also apply to APAs and CTPs and to require the provision on a reasonable commercial basis "including unbiased and fair contractual terms" and to ensure "non-discriminatory access" to such information. ESMA will develop draft regulatory technical standards that will specify what constitutes "unbiased and fair contractual terms" and what constitutes "non-discriminatory access to data" so these new operative provisions will not become effective until those technical standards are finalised and in force.

- *Transaction reporting*: The amendments to MiFIR included:

    - An expansion of the competent authorities to whom transaction reports must be forwarded beyond simply the competent authority of the most relevant market in terms of liquidity to include: the competent authorities responsible for the supervision of the transmitting investment firms, the branches which have been involved in the transaction (if relevant) and the trading venues used.

    - A change to the scope of transactions to be reported with regards to transactions in derivatives. This revised scope will mean that transactions in OTC derivatives other than those referred to in Article 8a(2) will only be reportable when executed on a trading venue (so the concept of "traded on a trading venue" (TOTV) derivatives not executed on venue will be removed) while those OTC derivatives that are referred to in Article 8a(2) will be reportable regardless of whether they are carried out on the trading venue. These Article 8a(2) derivatives are those that will be subject to the revised pre-transparency provisions – i.e. OTC derivatives that are denominated in euro, Japanese yen, US dollars or pounds sterling and which are (broadly): centrally cleared under the EMIR clearing obligation (and, in the case of interest rate derivatives, of one of 11 tenors), or are centrally cleared single-name credit default swaps referencing a global systemically important bank or an index comprising such a bank).

- Changes to the scope of information to be reported.

These new rules will only become applicable as and when the revised RTS 22 starts applying. Until then, the pre-28 March 2024 rules in MiFIR and RTS 22 will continue to apply. of

The remainder of this section largely looks at what ESMA has been, and will be, doing with regards to consultations on its draft amendments to existing technical standards and drafting new standards in response to the various mandates set out in the L1 amending acts.

MiFIR Review ESMA Consultation Package: Consolidated Tape Providers and Data Reporting Service Providers

On 23 May 2024, ESMA published a MiFIR Review Consultation Package containing draft technical standards related to Consolidated Tape Providers and Data Reporting Service Providers (**DRSPs**) and assessment criteria for the CTP selection procedure. Consultation closed on 28 August 2024. On 16 December 2024, ESMA published its MiFIR Review Final Report on new and revised technical standards related to consolidated tape providers (CTPs) and other data reporting service providers (DRSPs). The Commission has three months from submission of the final report to decide whether to endorse ESMA's RTS.

As outlined above, one of the things that the MiFIR amending Regulation did was to change the provisions around the establishment of consolidated tape providers (CTPs) and DRSPs. In this regard, ESMA had been mandated to develop draft regulatory technical standards (RTS) and to propose amendments to the relevant existing ones.

In outline, following consultation, the final report contains ESMA's RTS proposals in relation to the following:

- *RTS on input and output data of CTPs*:
  - Specifying (1) the minimum quality standards of protocols for data transmission, (2) the data to be disseminated by the CTP, (3) what constitutes "as close to real time as technically possible", and (4) the data that must be submitted to the CTP (including input data formats).
- *RTS on the revenue distribution scheme for the equity CTP*:
  - Specifying the weighting and the methodology for calculating the amount of a CTP's revenue that must be redistributed to data contributors – it includes the specification of criteria under which a CTP can suspend the participation of a data contributor in the revenue distribution scheme, and the conditions to resume the application of such scheme. In the final RTS, ESMA has provided more flexibility to the CTP in how it applies the scheme.

- *RTS on the synchronisation of business clocks*:
    - Specifying the level of accuracy to which business clocks must be synchronised.
- *RTS/ITS on the authorisation and organisation requirements for DRSPs*:
    - Amending RTS 13 (and the related ITS) to only apply to APAs and ARMs and adding a new RTS and new related ITS for the authorisation of CTPs, so that there will be two pairs of technical standards as follows:
        - Draft RTS on the authorisation of APAs and ARMs
        - Draft ITS on the authorisation of APAs and ARMs
        - Draft RTS on the authorisation of CTPs
        - Draft ITS on the authorisation of CTPs

Article 27da MiFIR (as amended) mandates ESMA to organise competitive selection procedures for the purposes of selecting entities that want to and are able to provide a consolidated tape. The consultation paper had set out ESMA's initial views on the assessment of CTP applicants, including a proposed distinction between selection and award criteria, considerations on the interactions between the assessment criteria and the existing and future provisions in Level 1 and Level 2 measures, and expectations on minimum requirements and key elements underpinning the relevant scoring methodology. On 16 December 2024, ESMA published a feedback statement on those assessment criteria. ESMA will finalise the technical specifications of its expectations for each of the criteria. These will be made public, together with the approach to the tender and the standard forms to be used. The first selection procedure for the CTP for bonds will be launched on 3 January 2025 (see below).

On 3 January 2025, ESMA announced the launch of the first selection procedure for the bond CTP, alongside the application specifications. The contract notice and procurement documents are available on the EU Funding & Tenders Portal. ESMA will assess the received requests against the exclusion and selection criteria: successful candidates will then be invited to submit their applications. ESMA intends to adopt a reasoned decision on the selected applicant by "early July 2025". Further information on the procedure is available on ESMA's Consolidated Tape Providers webpage.

Previously (in September 2024) ESMA had indicated that its intention to launch the selection procedure for the share and ETF CTF in June 2025, with the objective of adopting a reasoned decision on the selected applicant by the end of 2025.

MiFIR Review - ESMA Consultation Package 3 and final report – equity transparency

On 10 July 2024, ESMA published its third consultation package setting out its proposals on Level 2 technical standards to give effect to amendments resulting from the MiFID II and MiFIR Review. Consultation on some of the components closed on 30 September 2024, and for others on 15 October 2024.

ESMA expects to publish a final report in March 2025 which will include a new ITS on systematic internaliser notification, amendments to RTS 3 on the volume cap and a recast of RTS 7 containing new requirements on circuit breakers and targeted amendments to adapt the DORA framework.

On 16 December 2024, ESMA published its final report on equity transparency containing its technical advice and draft legislation (involving a number of amendments to Commission Delegated Regulation 2017/587 (RTS 1)) including:

- Changes to the definition of a liquid market for equity instruments. The new liquidity assessment for shares is now solely based on the market capitalization, rather than the free-float.

- The specification of the information to be disclosed for pre-trade transparency purposes, which is also of relevance to the equity consolidated tape

- The review of the pre-trade transparency requirements for systematic internalisers, including details on the two quoting sizes – i.e. minimum quote size and threshold up to which SIs must apply pre-trade transparency requirements determined on the basis of the standard market size (SMS) and the average value of transactions (AVT) buckets.

- Post-trade transparency reports (including the flags to be used for equity instruments).

- Amendments to the data source to be used for the performance of transparency calculations.

Consultation package 3 had included a proposed new RTS on the equity CTP in relation to input/output data – this relates shares and ETFs and to the input and output data – i.e. the data to be contributed to the equity CTP as well as the data to be published by the equity CTP. The final report on this component of the consultation was also published on 16 December 2024 (see above).

The Commission has three months, from submission of the final report on 16 December 2024, in which to decide whether to endorse ESMA's proposed amendments to the various RTS.

MiFID II/MiFIR Review: order execution policies

On 16 July 2024, ESMA published a consultation paper on technical standards specifying the criteria for establishing and assessing the effectiveness of investment firm's order execution policies. Consultation closed on 16 October 2024. The RTS was required to be submitted to the European Commission by 29 December 2024.

Under Article 1(4)(e) of the Directive amending MiFID II (see above), ESMA was mandated to develop regulatory technical standards on the criteria for establishing and assessing the effectiveness of firms' order execution policies, taking into account whether the orders are executed on behalf of retail or professional clients.

The consultation and draft RTS covered:

- *Classes of financial instrument*: Investment firms are required to distinguish between the different classes of financial instruments they offer. The draft RTS proposes that these classes of instruments should be based on the instruments groups of ISO Standard 10962. This means of classifying instruments is known as Classification of Financial Instruments (**CFI**) and is a six-letter code widely used in the industry and endorsed by the International Organisation for Standardisation. Alternatively, the narrative to the consultation suggests (but not the draft RTS) the RTS could include a fixed list of financial instrument classes, possibly based on the classification of instruments established by RTS 1 and RTS 2.

- *Pre-selection and list of venues*: Firms are required to specify in their order execution policy the internal governance procedures for the selection of execution venues and the measures taken to ensure that the selected execution venues are authorised by competent authorities, or third-country authorities. The draft RTS proposes requiring firms to include in their execution policies at least those venues that enable the firms to obtain, on a consistent basis, the best possible result for the execution of client orders.

- *Order routing criteria*: Where an order may be executed on two or more execution venues listed by the firm, the firm is required to specify in the policy the obligatory and discretionary criteria, and their relative importance, for identifying the execution venue that obtains the best possible result for executing a client order. Those criteria must take into account at least the class of financial instruments (see above) and whether the client is a retail or professional client and must be based on an analysis which must include certain factors (including, for instance, all costs directly related to the execution of the order, the size and nature of the order and real-time market data, or historical data). Where the firm uses an automatic order routing system, it must describe the main characteristics of that system in its order execution policy.

- *Monitoring of execution quality*: Firms must have a monitoring procedure to gauge the effectiveness of their order execution arrangements and order execution policy. The monitoring procedure must *assess* at least (a) the price of execution; (b) fees and costs applicable to each of the execution venues; (c) speed of execution; and (d) the result of the above criteria in accordance with the total consideration for retail clients and any alternative considerations for professional clients. The monitoring procedure must cover at least (a) the frequency of the monitoring (which must be at least once every three months); (b) the functioning of the firm's internal order execution arrangements and its impact on execution quality; (c) an assessment of all transactions of the firm, or a representative sample, for each class of instruments; (d) the thresholds to monitor execution quality for each class of financial instruments.

- *Assessment of the effectiveness of the order execution policy*: Firms must assess the effectiveness of their order execution policies at least annually, whenever the execution quality of the monitored transactions during a monitoring period breaches a predetermined threshold and whenever there is a material change to the order execution policy or the factors considered in that policy. The assessments must assess at least certain prescribed factors (e.g. price of execution compared to a reference dataset based on consolidated tape data or an alternative reference dataset; costs and charges; speed of execution etc).

- *Client instructions*: The execution policy should set out the arrangements for dealing with specific instructions from clients and define how to differentiate between orders with and orders without specific client instructions. When firms receive a specific instruction, they shall only treat the part or aspect of the order specified by the client as the specific client instruction – all other parts and aspects must be processed in the same way as orders without specific instructions. Where the firm offers or asks the client to choose an execution venue, the order execution policy must address certain details, including an explanation as to how the policy prevents the firm inducing the client to choose a specific venue and a warning to the client immediately before placing the order that the client's selection may prevent the firm from obtaining the best possible result.

- *Dealing on own account when executing client orders*: The firm must specify in its order execution policy the arrangements to ensure that the firm only deals on own account when executing client orders where the policy expressly provides that it may do this and that in doing so it still provides the best possible result for clients.

MiFID II/MiFIR Review: DPE regime for post-trade transparency of OTC transactions

The MiFIR Review introduced provisions empowering national competent authorities to grant the status of Designated Publishing Entities (**DPEs**) to investment firms. Under Article 21a MiFIR, DPEs, when they are a party to a transaction, are responsible for making the transaction public through an approved publication arrangement (**APA**).

ESMA was required to establish, by 29 September 2024, a public register of all DPEs specifying their identity and the classes of financial instruments (equity and non-equity instruments) for which they act as DPEs, based on information received from the national competent authorities.

However, the MiFIR Review did not set out any kind of transitional provision for the application of the DPE regime. Accordingly, ESMA and the NCAs agreed a two-stage approach whereby the DPE register would be (and was) published on 29 September 2024, with the new DPE regime becoming fully operational on **3 February 2025**.

The register is available on ESMA's Databases and Registers webpage (under "Financial Instruments (MiFID II, MiFID II Implementing regulation, OMNIBUS Directive") and further information is available on ESMA's MiFID II and MiFIR review webpage. The DPE Register is currently in downloadable XLSX format. ESMA is working on integrating the register into its IT systems so that, in future, it will be accessible via a dedicated portal. The indicative date for this integration is planned for the end of 2025, at which point the XLSX version will be discontinued.

MiFID II/MiFIR Review: ESMA consultation paper on transaction reporting and order book data

On 3 October 2024, ESMA published a consultation paper on the review of RTS 22 on transaction data reporting under Article 26 of MiFIR and RTS 24 on order book data to be maintained under Article 25 of MiFIR. Consultation closes on **17 January 2025** (an extension to the original deadline of 3 January 2025). ESMA will consider the feedback to the consultation and expects to publish its final report and submit its final draft technical standards to the European Commission in Q1 2025 (although the mandate itself gives a deadline of 29 September 2025).

As outlined above the amendments to Article 26 MiFIR included a change to the scope of transactions to be reported. This includes a recalibration of what OTC derivatives will be reportable and changes to the scope of information to be reported. As discussed, these new rules will (and can) only become applicable as and when the revised RTS 22 starts applying. Until then, the pre-28 March 2024 rules in MiFIR and RTS 22 will continue to apply.

The first part of the ESMA consultation therefore covers the draft amendments to RTS 22 in relation to transaction reporting in response to the mandate in Article 26(9) MiFIR as amended. Among other things, ESMA is required to specify the criteria for defining "the most relevant market" for a given financial instrument in terms of liquidity and details as to new transaction data elements and requirements.

The second part of the ESMA consultation sets out the proposed changes to RTS 24. The MiFIR Review did not introduce substantial amendments to Article 25 MiFIR (obligation to maintain records). In outline, the operator of a trading venue must keep at its disposal, for at least five years, the relevant data relating to all orders in financial instruments which are advertised through their systems. The only amendment is that such data must be kept in machine-readable format and using a common template. The mandate to ESMA introduces a requirement (over and above the existing requirement to specify the details) to set out the relevant *formats* of the relevant order book data. The consultation and draft amendments to the RTS therefore specify the amendments to define the machine-readable format and introduces some changes to the relevant fields in the pre-existing list of data elements set out in RTS 24.

EU LISTING ACT: AMENDMENTS TO MiFID II/MiFIR

WHAT IS THIS? Part of the EU Listing Act package which effected amendments to MiFID II and MiFIR.

WHO DOES THIS APPLY TO? MiFID investment firms and operators of trading venues.

WHEN DOES THIS APPLY? 6 June 2026 (the implementation deadline for the changes relating to investment research).

On 14 November 2024, the EU Listing Act package was published in the Official Journal. This package included:

- Directive (EU) 2024/2811 of 23 October 2024 amending Directive 2014/65/EU (**MiFID II**) and repealing Directive 2001/34/EC (**EU Listing Directive**). The EU Listing Directive must be transposed by Member States by 5 June 2026, to apply from **6 June 2026**.

- Regulation (EU) 2024/2809 of 23 October 2024 amending EU Prospectus Regulation (EU) 2017/1129 (EU Prospectus Regulation), the EU Market Abuse Regulation (EU) 596/2014 (EU MAR) and Regulation (EU) 600/2014 (**EU MiFIR**) (**EU Listing Regulation**). The EU Listing Regulation broadly came into force on 4 December 2024.

Amendments to MiFID II in relation to research

The changes effected by the EU Listing Directive to MiFID II relating to **investment research** are summarised below.

- *Article 24 MiFID II (general principles and information to clients)*: insertions to Article 24 as follows:
    - Research produced by investment firms or by third parties and used by, or distributed to, investment firms, their clients or potential clients shall be fair clear and not misleading. Research must be clearly identifiable as such "or in similar terms" provided that all the conditions laid down in the MiFID Org Reg applicable to the research are met.
    - Investment firms providing portfolio management or other investment services or ancillary services shall ensure that the research they distribute to clients/potential clients which is paid for (in full or in part) by an issuer shall be labelled as "issuer-sponsored research" only if it is

produced in compliance with the new EU code of conduct for issuer-sponsored research (see next bullet point).

- ESMA is required to develop RTS to establish the new EU code of conduct for issuer-sponsored research (see ESMA consultation below).

- Research that is labelled as "issuer-sponsored research" must indicate on its front page that it has been prepared in accordance with the EU code of conduct. Any other research material paid (in full or in part by the issuer) but not in compliance with the EU code of conduct must be labelled as a marketing communication.

- *Art 24(9a) MiFID II*: *joint payments for execution and research, regardless of market capitalisation:* article 24(9a) currently provides that the provision of research by third parties to investment firms providing portfolio management or other investment or other ancillary services to clients is to be regarded as fulfilling the obligation to e.g. act honestly fairly and professionally in accordance with the best interests of its clients (under Art 24(1)) where certain conditions are satisfied (an agreement has been entered into between the firm and research provider identifying the part of any combined charges/joint payments for execution services and research that is attributable to research; the investment firm informs its client about the joint payments; and research for which the combined charges or joint payment is made concerns issuers whose market capitalisation did not exceed €1 billion in the last 3 years). As amended, that market capitalisation condition will be dropped and instead paragraph 9a will provide that such research will fulfil the para 1 obligations where:

  - An agreement has been entered into between the investment firm and the third-party provider of execution services and research which sets out a methodology for remuneration, including how the total cost of research is generally taken into account when establishing the total charges for investment services (in substance, this is the same as now).

  - The investment firm informs its clients of its choice to pay either jointly or separately for execution services and research, and makes available to them its policy on payments for execution services and research and how it avoids conflicts etc (notifying the clients is not new, but the explicit references to the firm's choice as to whether to pay on a bundled basis or separately are new, as is the requirement to make its policy available).

  - The investment firm assesses on an annual basis the quality etc of the research and its ability to contribute to better investment decisions (ESMA may develop guidelines in relation to these assessments)(this is new).

  - Where the firm chooses to pay separately for execution services and third-party research, the provision of research by those third parties must be received in return for either direct payments by the firm out of its own resources or payments from a separate RPA controlled by the investment firm (a new provision clarifies that, in the case of separate payments, the fallback position of paying out of own resources or from a separate RPA applies).

- Some additional paragraphs are added to the end of *article 24(9a) MiFID II* which broadly provide that:

  - Trading commentary and other bespoke trade advisory services intrinsically linked to the execution of a transaction is not to be considered research

- Where the firm receives research from a research provider who is not engaged in execution services (and who is not a part of a group which includes an investment firm that offers execution services) the provision of the research is regarded as fulfilling the paragraphs 1 obligations (e.g. to act honestly fairly and professionally in the best interests of clients etc)

- Where known, the firm must keep a record of the total costs attributable to third-party research provided to them (on request, to be made available to clients on an annual basis)

- ESMA is to prepare a report on market developments on research by 5 December 2028.

ESMA consultation on amendments to MiFID II research provisions

On 28 October 2024, ESMA published a consultation paper containing draft technical advice to the European Commission on the amendments to the research provisions in MiFID II effected by the EU Listing Act. The consultation sets out ESMA's proposals to amend Article 13 of the MiFID Delegated Directive to reflect the new payment option that is available as a result of the EU Listing Act changes. The consultation closes on **28 January 2025**. ESMA expects to publish a final report submitting its technical advice to the European Commission in **Q2 2025** (the deadline by which ESMA is required to submit the technical advice is 30 April 2025).

Broadly, ESMA proposes to make relatively high-level changes to Article 13 of the MiFID Delegated Directive to align with the level 1 changes, to clarify how the conditions set out in level 1 apply and to introduce some high-level requirements applicable to the three different payment options available to investment firms. In brief, this involves:

- Minor amendments to the provisions of Article 13 of the Delegated Directive relating to the conditions applicable to the operation of a separate research payment account.

- The introduction of a new provision that states that, where a firm pays jointly for execution services and research, it must enter into an agreement for joint payments under which the methodology for remuneration must prevent the firm from paying substantially more for the research component than it would have done had it paid directly for it on an "unbundled" basis and does not impede the firm's ability to comply with the best execution requirements.

ESMA consultation on draft RTS for the establishment of an EU code of conduct for issuer-sponsored research

As outlined above, investment firms that produce or distribute research that is partly or fully funded by the relevant issuer can only use the label "issuer-sponsored research" if the research complies with the EU code of conduct for such research (ESMA is mandated to develop this). Any other research material paid (in full or in part) by the issuer but not in compliance with the EU code of conduct must be labelled as a marketing communication instead.

On 18 December 2024, ESMA published a consultation paper setting out draft regulatory technical standards for the establishment of an EU code of conduct for issuer-sponsored research. Consultation closes on **18 March 2025**. ESMA will consider the feedback received and expects to publish a final report and submit the draft RTS to the European Commission for endorsement "by 5 December 2025".

Amendments to MiFID II – SME growth markets

The EU Listing Directive effected a number of changes to MiFID II relating to MTFs registering as SME growth markets (or segments thereof) and the specific conditions that apply to the admission of shares to trading on a regulated market.

On 12 December 2024, ESMA published a consultation paper that included draft technical advice to the European Commission in relation to the implementation of the MiFID II amendments relating to SME growth markets and the proposed amendments to the MiFID Org Regulation and the MiFID Delegated Directive in this regard. Consultation closes on **13 February 2025**.

Amendments to EU MiFIR – keeping relevant data

The only changes to EU MiFIR under the EU Listing Regulation are to Article 25 which relate to the obligation on the part of the operator of a trading venue to keep (for at least 5 years), at the disposal of the relevant competent authority, relevant data relating to all orders in financial instruments in a machine-readable format and using a common template. These changes are, with one exception, identical to the MiFIR Review changes discussed above; the exception is that, under the EU Listing Regulation textual amendments, the competent authority may request those data on an ongoing basis. The mandate to ESMA under the EU Listing Regulation to draft RTS is also identical to the mandate under the MiFIR amending Directive (see above) – i.e. to develop RTS to specify the details and formats of the relevant order data required to be maintained as above – except that under the EU Listing Regulation the mandate is expanded to provide that ESMA's draft RTS shall include certain information (e.g. the identification code of the member or participant which transmitted the order, the identification code of the order, the date and the time the order was transmitted etc). Under the EU Listing Regulation, ESMA is required to submit its draft RTS to the Commission by 5 September 2025.

The EU Listing Act amendments to EU MiFIR and the mandate to ESMA are, for the most part, duplicative of those contained in the MiFIR Review amending Regulation. ESMA's October 2024 consultation paper on the review of RTS 22 on transaction data reporting under Article 26 of MiFIR and RTS 24 on order book data to be maintained under Article 25 of MiFIR (see above) makes no reference to the duplicative amendments under the EU Listing Regulation, or the separate mandate to ESMA under that Regulation. As mentioned above, ESMA is aiming to deliver its draft RTS to the Commission in Q1 2025 (not September 2025).

EU RETAIL INVESTMENT DIRECTIVE AND REGULATION – MIFID ASPECTS

WHAT IS THIS? Proposed amendments to MiFID II largely to introduce new enhanced investor protection requirements.

WHO DOES THIS APPLY TO? EU MiFID investment firms.

WHEN DOES THIS APPLY? Not yet known.

The Retail Investment Directive (discussed in EU Retail Investment Directive and Regulation – Funds Aspects above) also includes amendments to MiFID II. As mentioned in that section, despite the proposals being framed as a *Retail* Investment Strategy, some of the changes will apply to MiFID investment firms dealing with professional clients.

Key proposed changes to MiFID II include:

- Modifications to the criteria for elective professional opt-ups.
- Enhanced product governance rules.
- The extension of the ban on inducements.
- A new concept of "marketing communication" with additional contents and governance requirements.
- Enhanced disclosures on costs and charges.

We discussed the proposals further in our 2024 New Year Briefing (**Financial Services Regulation 2024 - New Year briefing | Travers Smith**).

As discussed above, it is not yet clear when the final changes will come into force but it is likely to be 2026 at the earliest.

HM TREASURY: POLICY PAPER – NEXT STEPS FOR REFORMING UK MiFID

WHAT IS THIS? An HM Treasury policy paper on the next steps for reforming the UK Markets in Financial Instruments Directive.

WHO DOES THIS APPLY TO? All MiFID investment firms and other firms subject to MiFID-derived legislation.

WHEN DOES THIS APPLY? Not yet stated.

On 14 November 2024, HM Treasury published a policy paper on the next steps for reforming the UK Markets in Financial Instruments Directive.

In truth, the "policy paper" was little more than a one-page confirmation of the government's high-level commitment to make further legislative changes to the MiFID framework.

- To legislate to give the FCA fuller powers of direction in relation to the reporting of OTC positions in the context of the UK commodity derivatives markets
- To start the revocation of the firm-facing requirements in the Markets in Financial Instruments Regulation (MiFIR) relating to transaction reporting, and delegating to the FCA the power to circumscribe the new regime in its rules
- To revoke the firm-facing regulations within the Markets in Financial Instruments Directive (MiFID) Organisational Regulation, thus enabling those requirements to be replaced with rules in the FCA Handbook (see the next item, the FCA's consultation on how it intends to restate the MiFID Organisational Regulation).

FCA: RESTATEMENT OF THE MIFID ORGANISATIONAL REGULATION AND FUTURE AMENDMENTS

WHAT IS THIS? An FCA consultation on its proposals to restate the firm-facing requirements in the 'onshored' MiFID Organisational Regulation in its Handbook by way of rules and guidance, together with a "discussion chapter" on possible future amendments to the existing EU-derived organisational and conduct rules.

WHO DOES THIS APPLY TO? MiFID investment firms (including credit institutions and collective portfolio management investment firms); MiFID optional exemption "Article 3" firms; third country firms; UCITS managers, residual CIS operators; small authorised UK AIFMs; OPS firms; recognised investment exchanges (RIEs).

WHEN DOES THIS APPLY? The consultation on restating the MiFID Organisational Regulation closes on **28 February 2025** – having considered the feedback, the FCA will publish a policy statement in H2 2025. The finalisation of the rules will be consistent with the government's timetable repealing the MiFID Organisational Regulation. The feedback period for the discussion questions raised in Chapter 4 of the consultation paper closes on **28 March 2025**. Following feedback on that, the FCA will consider its priorities. Any concrete policy proposals will then be subject to formal consultations including proposed rule changes.

On 27 November 2024, the FCA published CP24/24: The MiFID Organisational Regulation. (The PRA published a statement the same day saying that it plans to publish its equivalent consultation paper in Q1 2025 with a view to publishing a policy statement on the same day as the FCA in H2 2025.)

The bulk of the FCA consultation (and attached draft rules) addresses the FCA's proposals to transfer the firm-facing requirements of the MiFID Organisational Regulation into FCA Handbook rules as and when the Treasury begins the repeal of that Regulation. Consultation on this exercise in restatement closes on **28 February 2025**.

The paper also included a discussion chapter about further reform, "either now or in the future" to calibrate the rules further. The period for feedback on these high-level topics for discussion closes on **28 March 2025**.

Restatement of the MiFID Org Regulation

The bulk of the consultation paper relates to the proposal to restate the MiFID Org Regulation in the FCA rules with no, or minimal, changes. Although the migration will inevitably involve some detailed corrections and adjustments (the draft amending instrument runs to nearly 250 pages), the FCA is not proposing any policy changes of substance. As the regulator puts it, no new requirements on firms are proposed and no existing requirements will be removed. So, the restatement will essentially be a "functional" exercise, pending future amendments at some point in the longer term which will reflect the FCA's policy-driven approach to investment firms. For the time being therefore, the fundamental concepts will not change and the distinction in the rules between MiFID business and non-MiFID business will continue.

Points for discussion

Aside from the consultation on the restatement of the MiFID Org Regulation, CP24/24 also includes a "discussion chapter" (Chapter 4) headed "Future amendments to EU Derived Organisational and Conduct rules". Feedback comments on the points of discussion are invited by **28 March 2025** (a 16-week feedback period).

Importantly, while Chapter 4 does set out some points identified as being possible candidates for change at some point in the future – in respect of which the FCA clearly has some views and on which it is seeking some "early feedback" – there are no finalised policy proposals at this stage, and no draft Handbook text. The FCA says it will only propose future amendments to the relevant rules if it determines that there is a clear benefit in doing so and in all cases any changes will be subject to consultation and a cost benefit analysis. However, firms and their industry associations will want to have a hand in setting the agenda and tabling their views by giving their early feedback on some of the high-level but substantive issues under discussion.

The discussion chapter is broadly split into three groupings for consideration:

- *Immediate (presumably short-term) opportunities* for potentially rationalising and reducing the complexity and length of the Handbook. This includes rationalisation in the following, relatively non-contentious, areas:
    - The various, but substantially similar, conflict of interest rules in SYSC 10 (read in conjunction with SYSC 1 Annex 1).
    - The best execution rules in COBS 11.2 (for AIFMs and residual CIS operators), COBS 11.2A (for MiFID firms) and COBS 11.2B (for UCITS management companies).
    - The non-MiFID and MiFID personal account dealing rules in COBS 11.7 and COBS 11.7A.
    - Otherwise reducing the complexity and length of the Handbook by, for instance, reducing unnecessary duplication across EU-derived rules.
    - The Level 3 materials (and others) on which firms rely for interpretation of the EU-derived rules.
- *More complex opportunities for rationalisation* – in relation to some of the other areas the FCA has identified, it believes that changes are merited but concedes that they would be more complex to institute and would have a more material impact on firms. The FCA majors on the topic of client categorisation here (see below).
- *Long-term changes* – in this regard, as part of the more strategic changes that might be made over the "long-term" (no particular timescale is mentioned) the FCA is considering whether the requirements for firms may – at some point in the future – be set by reference to the risks of harm presented by a firm's business model, rather than by way of what will become the "legacy" distinction between MiFID and non-MiFID business.

The FCA also considers at some length (but at a high level) possible ways in which the existing regime applicable to Article 3 MiFID optional exempt firms might be updated in a "post-MiFID world", although it is unclear whether the FCA sees these as "long-term changes" – some of them would certainly have a material impact on some firms (see below).

Client categorisation – discussion points

In the section of the discussion chapter headed "more complex opportunities for rationalisation" consideration is given to changes that might be made to the client categorisation regime. Particular focus is given to the possibility of introducing more flexibility into the elective professional "opt-up" process (significant elements of which are MiFID-derived) including by way of:

- Updating and/or adding alternative "quantitative test" criteria including, for instance, by adding product-specific criteria or alternative indicators of a client's expertise, knowledge and experience and/or adjusting the asset threshold test in the quantitative test (currently €500,000).

- Aligning the MiFID and non-MiFID tests. In this regard, it is not entirely clear whether the FCA is floating the idea of removing the MiFID quantitative test altogether, although the narrative does refer to the possibility of giving firms the flexibility of a qualitative test in designing their policies and procedures and the clients that they provide those services to so this may be the intention. This approach might be qualified by additional FCA Handbook guidance on the assessment criteria that firms should use and possibly introducing a minimum portfolio threshold as a prerequisite to opting up (which, even if the MiFID quantitative test were to be dropped, would introduce a quantitative criterion into the otherwise qualitative nature of the assessment).

- Enhancing the opt-up process generally, including the possibility of having more Handbook guidance, introducing a "cooling-off period" and introducing a requirement that opted-up clients might have to confirm on a periodic basis that they want to remain as professional clients, failing which they would revert to retail client status.

As regards the interrelationship between the financial promotion requirements in the FCA Handbook and the use of the client categorisation terminology and methodology to classify financial promotion recipients, the FCA queries whether it remains appropriate for "opted-up" recipients to be exempt from certain financial promotion rules (many of the financial promotion rules are disapplied in relation to promotions made to recipients categorised as "non-retail clients").

Finally, on client categorisation, the FCA touches on corporate finance contacts and venture capital contacts. Much of the discussion is centred on a factual description of how the respective contact regimes currently operate, concentrating on the fact that the relevant firm must not give any indication to the contact, as the potential investor, that they are treated as a client, and must not behave in any way which might reasonably be expected to lead the contact to believe they are being treated as a client. Given these requirements, the FCA ponders whether the process of opting-up a contact to elective professional status might risk the contact believing that they are being treated as a true client (rather than being categorised for the purposes of the financial promotion requirements). This touches on the inevitable tension that arises in having to use the client categorisation terminology and processes when opting-up a financial promotion recipient who will not and cannot be a client of the firm.

Article 3 MiFID optional exemption firms

An entire section at the end of the discussion chapter looks at article 3 exempt firms. As mentioned above, it is not clear whether the FCA considers this topic to fall under its "long-term changes" grouping (it certainly follows after the relevant heading), or whether the FCA sees this as a standalone issue which might, subject to feedback and the FCA's assessment of the risks and benefits associated with this type of investment firm, be prioritised under the new, rule-making framework.

By way of background to the discussion, reference is made to the fact that, under the Financial Services and Markets Act 2023, a number of provisions in assimilated law will be repealed (subject to commencement). This will include Part 2 of the UK MiFI Regulations meaning that the current requirements on the activities of Article 3 firms will be removed (i.e. the firm must not hold clients' funds or securities, does not provide any investment service other than reception and transmission of orders and the provision of investment advice and only transmits orders to certain entities (e.g. a duly-authorised investment firm, a duly-authorised credit institution or a UK or EU UCITS). The Treasury and the FCA are currently considering the policy options, once these requirements are scrapped. These could include considering what activities Article 3 firms will be permitted to carry out under the new framework once the MiFID connection is severed. No details are provided as to what activities the regulator might be considering.

The FCA is at pains to stress that, at this point, it is not proposing any changes to the MiFID-derived rules applicable to Article 3 firms. However, it is clear that it has some changes in mind, making explicit reference to the fact that Article 3 firms are subject to a different prudential treatment than the one that applies to MiFID investment firms. It makes the point that the original rationale for the different (and beneficial) prudential treatment was that, at the time, EU prudential regulation largely amounted to an implementation of the Basel regime for banks and was not appropriate for non-bank firms that carried out investment (and, by extension, not appropriate for Article 3 exempt investment firms). However, the FCA notes that "this is no longer the case and there is now a separate prudential regime designed for firms that do investment business"; this is a reference to UK IFPR and the MIFIDPRU rules (derived to a significant extent from the EU IFR/IFD regime). The implication is that the FCA may be considering "levelling up" Article 3 firms to the rules that apply to MiFID investment firms for prudential purposes. If this were to crystallise into a formal policy proposal, it would have a material impact on Article 3 firms.

Any proposed amendments to the prudential regime applicable to Article 3 firms will be subject to consultation in the future.

Aside from the prudential rules, there are, in practice, very few substantive differences between the conduct and organisational requirements that apply to MiFID investment firms and those which apply to Article 3 firms (the exceptions being the telephone taping rules, client categorisation, record-keeping and knowledge and competence). The FCA will therefore be looking to remove artificial distinctions between MiFID and non-MiFID/MiFID exempt requirements "if there is no material difference in the obligations".

PAYMENT OPTIONALITY FOR INVESTMENT RESEARCH – MiFID INVESTMENT FIRMS

WHAT IS THIS? The FCA's new rules allowing for MiFID investment firms to have an additional option of being able to buy investment research on a bundled-basis.

WHO DOES THIS APPLY TO? MiFID investment firms – in practice, this will primarily be relevant to segregated portfolio managers and some independent investment advisers (and of interest to the asset owner clients of such managers – e.g. pension schemes). While technically available to other MiFID firms – e.g. adviser arranger firms – in practice, because they will lack the necessary "interface" with the sell-side broker, they will need to continue to pay for bundled research from their own balance sheets or accept it on the basis of having satisfied the quality enhancement test.

WHEN DOES THIS APPLY? 1 August 2024.

The FCA consulted on the new payment optionality rules in April 2024 – see our briefing **Consultation on payment optionality: a bundle of joy?** That consultation had set out the FCA's proposals, in light of one of the recommendations from the Independent Research Review (IRR), to give firms the option of choosing an additional way to receive investment research without it constituting an inducement. Broadly speaking, this new option allows buy-side firms buy research on a bundled basis – i.e. by way of joint payments for research and execution services – subject to conditions relating to the operation of such joint payments, referred to by the FCA as "guardrails". Previously, the concept of bundling had been anathema to the FCA.

In July 2024, the FCA published its final rules in PS24/9: Payment Optionality for Investment Research. The changes to the research rules came into force on 1 August 2024. The new payment option is in addition to the pre-existing ways in which firms may receive third party research without it constituting an inducement – i.e. where it is received in return for direct payments by the firm out of its own resources or payments from a separate research payment account, operated in accordance with detailed requirements.

In outline, the "guardrails" that firms must comply with if they are to avail themselves of the new payment optionality, require:

- A **written policy** describing the firm's approach to joint payments, including with respect of governance, decision-making and controls.
- An arrangement setting out the **methodology for calculating and separately identifying the cost of research**.
- A structure for the **allocation of payments between research providers**, including IRPs.
- An approach for the **allocation across clients of the costs of research** purchased through joint payments.
- **Periodic assessment** of the value, quality, use and contribution to investment decision-making of the research purchased.
- **Disclosure to clients** on the firm’s approach to joint payments.

- **Operational procedures** for the administration of accounts used to purchase research, and for the delegation of such responsibilities to others.

- **A budget** to establish the amount needed for third-party research, reviewed and renewed at least annually, and based on expected amounts needed to purchase such research as opposed to volumes or values of transactions.

The "guardrails" are not dissimilar to the conditions that apply to the operation of a research payment account. It is doubtful that there will be much "take up" among buy-side firms. When finalising the rules for buy-side MiFID firms, the FCA stated that its policy intention was to roll out the same optionality "in substance" to fund managers, including AIFMs and UCITS managers. In November 2024, the FCA consulted on this in CP24/21: Investment research payment optionality for fund managers – see above.

UK CONSOLIDATED TAPE: AN UPDATE

WHAT IS THIS? The process for establishing a consolidated tape.

WHO DOES THIS APPLY TO? Any firms interested in bidding to become the CTP for bonds and/or equities; trading venues which admit to trading, or trade, bonds (and, in time, equities); APAs who publish trade reports for bonds (and, in time, equities) on behalf of investment firms; ARMs who send transaction reports to the FCA on behalf of investment firms. The rules will also be of interest to investment firms who use market data and market data vendors.

WHEN DOES THIS APPLY? The new rules came into force on 5 April 2024. The FCA has been developing a bond CTP tender process over the last few months. It will publish draft tender documents by 31 January 2025. It is not yet clear when the appointed bond CTP will eventually commence operation, but certainly not before 1 December 2025 when the changes to the UK bond transparency regime will take effect. As regards the development of an equities consolidated tape, the FCA is seeking expressions of interest from potential equity CTPs by 10 January 2025.

Bond consolidated tape

We reported on the FCA consultation, policy statement and final rules on the framework for the UK consolidated tape in our **New Year Briefing 2024**. At the time, the FCA said it would be developing a CTP tender process and expected to make an appointment "in the course of 2024", with the appointee commencing operation in the first half of 2025. In April 2024, the FCA confirmed (in Handbook Notice 117) that, contrary to what it had previously proposed, it would not require the bond CPT to make payments to data providers.

As it happens, timing has slipped. In early December 2024, the FCA announced that it was starting the process of appointing a bond CT provider and published a Concession Notice setting out the next steps for the running of that tender process.

The FCA intends to publish tender documents by **31 January 2025**, which will contain full details of the bidding process. The CTP will not be required to go live before the bond transparency regime changes take effect on 1 December 2025.

Equities consolidated tape

The FCA's work on establishing an equities consolidated tape is moving on a slower track. In August 2024, the FCA appointed consultancy firm Europe Economics to conduct an analysis of including pre-trade data in an equities consolidated tape. On 16 December 2024, the Final Report from Europe Economics was published together with an FCA update. The FCA feels that it needs to work further with industry to "fully assess the likely demand for an equity tape" before being in a position to proceed to consultation on the policy options. It will engage with the industry on possible design options "early in 2025", working towards the publication of a consultation paper later in 2025. As an initial step, it has invited those interested in becoming the equities consolidated tape provider to provide expressions of interest by 10 January 2025.

TRADE REPORTING FOR BOND AND DERIVATIVES MARKETS

WHAT IS THIS? FCA policy statement and final rules on improved transparency for bond and derivatives markets (together with a Discussion paper on the future of the systematic internaliser regime).

WHO DOES THIS APPLY TO? Trading venues and investment firms dealing OTC in bonds and derivatives.

WHEN DOES THIS APPLY? The new transparency rules apply from 1 December 2025. The closing date for comments on the embedded Discussion Paper on the systematic internaliser regime is 10 January 2025.

In November 2024, the FCA published PS24/14: Policy Statement for Improving transparency for bond and derivatives markets. Chapter 9 of the paper included an "embedded" Discussion Paper on the Future of the SI regime.

As we discussed in our **New Year Briefing 2024**, the FCA consulted on improving transparency for bond and derivatives markets at the back end of 2023. In the policy statement, the FCA is essentially proceeding with the changes it consulted on. The new rules will come into effect on **1 December 2025**.

The key changes that are relevant to investment firms, therefore, are as follows:

- There has been a narrowing of the types of bonds and derivatives subject to trade reporting. In future, only the following types of bonds and derivatives will be subject to trade reporting by investment firms:
    - Bonds traded on a UK trading venue; and
    - Certain OTC derivatives that are subject to the clearing obligation under EMIR.
- The reporting deferrals regime will be simplified for those bonds and derivatives that remain in scope of trade reporting as above. This includes:

    - Only permitting deferrals based on the size of the transaction (as opposed to the other factors that can apply under the current regime); and

    - No longer permitting the reporting of aggregated trade data.

- There are minor additions to the types of transactions in bonds and derivatives that are excluded from the trade reporting regime, to align with the changes made in relation to equity transactions under the amended technical standards finalised in PS23/4: Improving Equity Secondary Markets.

- There are also minor changes to certain reporting fields.

5 PRUDENTIAL REGULATION

ITEMS COVERED IN THIS SECTION

EU INVESTMENT FIRMS REGULATION AND DIRECTIVE

WHAT IS THIS? Discussion paper on possible changes to the EU Investment Firms Regulation and Investment Firms Directive.

WHO DOES THIS APPLY TO? EU MiFID investment firms but some proposals will be of interest to EU AIFMs and UCITS management companies.

WHEN DOES THIS APPLY? Not yet known.

The EU continues to publish supplementary rules and guidance on the EU Investment Firms Regulation and Investment Firms Directive (**IFR/IFD**) with the Final Guidelines on the Group Capital Test in April 2024, Commission Delegated Regulation (EU) 2024/1771 with RTS on the prudential consolidation of an investment firm group in June 2024 and Final Draft ITS on the reporting of information on certain K-factor requirements in December 2024. However, despite work not having yet finished on the first iteration of IFR/IFD, ESMA and the EBA have already issued a discussion paper on possible changes to IFR/IFD: Call for advice on the investment firms prudential framework. The deadline for comments was 3 September 2024.

The call for advice included some suggestions which provide some insight into possible future tweaks to the regime. Although the points will be primarily of interest to EU MiFID investment firms, a number of the proposals would, if adopted, have an impact on EU AIFMs and UCITS management companies.

Possible changes discussed in the call for advice included:

- *Fixed Overheads Requirement:* Varying the minimum own funds requirement according to the activities of the firm. The call for advice also included questions around how expenses related to tied agents, non-MiFID activities and FX rates difference should be treated.

- *AIFMD and UCITS Top-Ups:* Imposing capital requirements under IFR/IFD on AIFMs and UCITS management companies providing MiFID top-up services or introducing requirements limiting the amount of top-up services that an AIFM or UCITS management company can provide.

- *K-Factors:* Changes to the K-factor calculations including clarification of the concept of *"recurring provision of investment advice"* for the K-AUM calculation and including delegated assets under advice in the IFR exemption for delegated assets under management. A potential new K-factor for exposures in crypto-assets and changes to the treatment of firms operating MTFs and OTFs were also discussed.

- *Liquidity requirement:* Increasing the liquid assets requirement, for example, to require firms to hold three months' worth of the fixed overheads requirement or to take into account the liquidity profile of the firm. The removal of the exemption from liquidity requirements for small and non-interconnected investment firms was also suggested.

- *Prudential consolidation:* Finetuning the definitions used for prudential consolidation. Also limiting the application of the group capital derogation to groups with a maximum number of undertakings and/or maximum value of assets.

- *Remuneration:* Questions around whether the differences between AIFMD/UCITS Directive and IFD remuneration requirements (e.g. scope of application, remuneration policies and variable remuneration) cause problems in practice.

- *Reporting:* Extending reporting requirements to include additional accounting and financial information.

EU CAPITAL REQUIREMENTS DIRECTIVE VI

WHAT IS THIS? Requirement for third country undertakings carrying on core banking services in the EU to establish licensed branches in Member States.

WHO DOES THIS APPLY TO? Third country undertakings carrying on core banking services in the EU.

WHEN DOES THIS APPLY? 11 January 2027.

The forthcoming Directive (EU) 2024/1619 (known as CRD VI) includes a requirement for third country undertakings providing core banking services in the EU to establish a licensed branch in each Member State in which they operate.

The requirement applies to an undertaking established outside the EU which meets either of the criteria below:

- it is carrying out deposit taking in an EU member state; or

- it is lending or carrying on activities in respect of guarantees or commitments in an EU member state *and* is either a credit institution or a very large investment firm (broadly a firm with consolidated assets over EUR 30 billion which is dealing on own account or underwriting/placing on a firm commitment basis).

For the most part, this is expected to be relevant to non-EU banks lending to entities based in the EU. Although funds (including credit funds) and special purpose vehicles are generally unlikely to be caught by the requirement to establish a branch, EU funds and special purpose vehicles may find that the new requirements mean that fewer non-EU banks will be prepared to offer credit to them. The obligation to establish a branch in each relevant member state, with the associated regulatory requirements, may prove unattractive to non-EU banks and may result in them reconsidering the business that they carry on with EU entities.

There are several exemptions which non-EU banks may wish to explore. These include an exemption for reverse solicitation which could be useful in certain cases depending on the facts. There are also exemptions for lending to group entities and to credit institutions. The EBA is also mandated to review whether to extend the lending to credit institutions to lending to other financial sector entities. The asset management industry may wish to consider whether this is worth exploring but any extension in scope may require very careful drafting in order to prevent unintended consequences.

The requirement will apply as from **11 January 2027**.

REVISED CHANGE IN CONTROL GUIDELINES

WHAT IS THIS? Revised guidance on change in control.

WHO DOES THIS APPLY TO? Persons seeking to acquire or increase control of FCA or PRA authorised firms.

WHEN DOES THIS APPLY? 1 November 2024

In November 2024, the FCA and PRA published their policy statement on updated guidance on the prudential assessment of acquisitions and increases in control: PS18/24: Prudential assessment of acquisitions and increases in control. This followed a joint consultation (CP25/23) which we discussed in our 2024 New Year briefing.

The updated guidance from the FCA is set out in FG24/5: Prudential assessment of acquisitions and increases in control (**Guidance**) and took effect on 1 November 2024. It essentially replaces the previous guidance on changes in control in SUP 11 Annex 6G and the EU joint guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector. The PRA's guidance was issued in a revised supervisory statement: SS10/24 – Prudential assessment of acquisitions and increases in control.

The Guidance largely reflects the previous approach to changes in control but also provides some additional example situations as well as example structure charts to illustrate how controllers should be determined. The FCA states that the Guidance is not exhaustive and there may be cases where it is necessary for it to take an approach which is not described in the Guidance.

Following representations from the private equity industry, some limited additional guidance is included on limited partnership structures. However, the FCA says that ultimately private equity structures and similar types of fund structures will be considered by the FCA on a case-by-case basis.

The FCA also clarified its position on when a person would be considered to have significant influence for the purposes of assessing control. It had originally stated that mere membership of board of the authorised firm or its parent would be relevant, which caused some concern. The FCA instead revised the FCA Guidance so that the relevant person must have the ability to direct or influence decisions made by the board (which could be via a shareholder board appointment to the authorised firm or its parent or otherwise).

In circumstances where a person may not be aware in advance of a change in control or have any influence over it, the FCA said that it would look to the s178 notice given to include such controllers in its own notification. The FCA may then require further information on those persons to be provided.

The FCA also clarified that pre-notification for complex or high-risk transactions is a recommendation rather than a requirement. The FCA deleted the provision that a controller acquiring two or more authorised firms would be likely to have to provide information on conflicts of interest but added that prior engagement may be required where the proposed transaction is likely to create a larger firm or group with significant market share.

6 FINANCIAL MARKETS INFRASTRUCTURE AND PAYMENTS

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
January 2025	Accelerated Securities Settlement (covered in Bank of England FMI Supervision)	Expected publication of the (due by end 2024) final report of the Accelerated Settlement Taskforce Technical Group
17 January 2025	Future of Open Banking	Intended date of FCA announcement on the operator of the multilateral agreement covering variable recurring payments (**VRPs**)
21 January 2025	Future of Open Banking	Next House of Lords session on the Data (Use and Access) Bill
24 January 2025	Regulated Liability Network (covered in National Payments Vision)	Deadline for firms to register their interest in participating in the next phase of the Regulated Liability Network
27 January 2025	EU EMIR3	ESMA consultation on the active account requirement closes
28 January 2025	Future of Open Banking	Further House of Lords session on the Data (Use and Access) Bill
19 February 2025	FMI Fundamental Rules	Bank of England consultation closes
1 February 2025	Bank of England FMI Supervision	HM Treasury to commence sending written recommendations to the Bank of England's FMI Committee
February 2025	Bank of England FMI Supervision (Digital Securities Sandbox)	Early sandbox entrants gain approval to pass through Gate 2
13 March 2025	Bank of England FMI Supervision (Operational Resilience)	Consultation on operational incident and outsourcing and third-party reporting (**IOREP**) closes

31 March 2025	Bank of England FMI Supervision (Operational Resilience)	Deadline for FMIs to have taken all reasonable actions to remain within their operational resilience impact tolerances
Q2 2025	FCA Safeguarding	Possible FCA Policy Statement on safeguarding regime for e-money and payments firms
25 June 2025	EMIR3	Deadline for ESMA to draft RTS on the active account requirement
30 June 2025	National Payments Vision	Deadline for Payments Vision Delivery Committee (**PVDC**) to publish its initial plan for retail payments infrastructure and Pay.UK
H1 2025	Future of Open Banking	Aspiration for completion by PSR of phase 1 of the variable recurring payments work and possible consultation by FCA on phase 2
H1 2025	Bank of England FMI Supervision	*Possible* consultation on CPMI-IOSCO's work on FMIs' implementation of Principle 15 of the PFMIs
H2 2025	EU PSD3	Likely point for text to be adopted
Summer 2025	Bank of England FMI Supervision	New publication date for Bank of England Annual Report on FMI supervision
No later than Q3 2025	Accelerated Securities Settlement (covered in Bank of England FMI Supervision entry)	Possible technical and legislative work on accelerating securities settlement in the EU
7 October 2025	National Payments Vision	PSR to review the impact of its APP fraud reimbursement requirements
Q4 2025	Bank of England FMI Supervision (Digital Securities Sandbox)	First Gate 3 (scaling stage) review point
"In" 2025	Bank of England Supervision of FMIs (Repeal and Replacement of UK EMIR)	Bank of England to consult on proposals to transpose UK EMIR into Bank rules from legislation
"In" 2025	RTGS availability (covered in National Payments Vision)	Bank of England to publish consultation paper
"In" 2025	FMI Fundamental Rules	Final rules and guidance to be published by the Bank of England
"In" 2025	Bank of England Supervision of FMIs	Bank of England to consult on its approach to reviewing its FMI rules

"In" 2025	Bank of England Supervision of FMIs	Expected time for HM Treasury to set the scope of the permissions power, at which point the Bank will consult on its approach to using the permissions power
"In" 2025	Central Bank Digital Currency (covered in National Payments Vision)	Expected decision by HM Treasury on whether to launch a UK CBDC
25 December 2025	EMIR3	Deadline for ESMA to submit other technical standards under EMIR3
31 December 2025	National Payments Vision	Deadline for PVDC to publish the full Payments Forward Plan and a recommended monitoring approach
End 2025	Regulated Liability Network (covered in National Payments Vision)	Aim to carry out live pilots for identified use cases
25 June 2026	EMIR3	Deadline for implementation in Member States
Q4 2027	Accelerated Securities Settlement (covered in Bank of England FMI Supervision)	Proposed migration to T+1 for settlement of shares and other relevant securities in the UK and EU

ITEMS COVERED IN THIS SECTION

EUROPEAN MARKET INFRASTRUCTURE REGULATION (EMIR3)

WHAT IS THIS? New legislation amending EU EMIR.

WHO DOES THIS APPLY TO? CCPs operating in the EU, and their EU participants.

WHEN DOES THIS APPLY? Most of the requirements will have entered into force on 24 December 2024, albeit with various ESMA mandates to be fulfilled through 2025.

As predicted in **last year's briefing**, the package of measures to reform EU EMIR was – albeit in a rather tortuous fashion with multiple corrigenda – approved by the EU legislative bodies. Having been published in the Official Journal on 4 December 2024, the package entered into force on **24 December 2024**.

Member States are required to transpose Directive (EU) 2024/2994 by **25 June 2026**. Before that, ESMA is required to submit to the European Commission several sets of regulatory technical standards by (and one presumes that it will be well before) **25 December 2025**.

Our Derivatives & Structured Products colleagues have produced a **briefing** looking at the impact on buy-side participants.

As our previous briefings over the course of 2024 noted, the active account requirement (**AAR**) continued to be the source of controversy. ESMA must produce draft RTS on the application of this requirement by **25 June 2025**, and in fact got started very early by publishing its consultation on the implementation of the AAR on 20 November 2024 – only a single day after the legislative package had been adopted by the Council. That consultation period is open until **27 January 2025**.

A key objective of EMIR3 is clearly to incentivise the movement of clearing volumes to EU CCPs (hence the introduction, even if somewhat diluted, of the AAR, along with requirements to inform clients of the ability to clear their trades through an EU CCP). In addition, there will be greater levels of cross-border regulatory co-operation and alignment. Third-country CCPs that provide clearing services in the EU (most obviously, those based in the UK) are also likely to be impacted by the "enhancements" to regulatory supervision and may face heightened scrutiny from supervisors.

PROPOSED THIRD PAYMENT SERVICES DIRECTIVE/PAYMENT SERVICES REGULATION (PSD3)

WHAT IS THIS? New EU legislation amending PSD2.

WHO DOES THIS APPLY TO? All payment services providers (**PSPs**) operating in the EEA.

WHEN DOES THIS APPLY? It is now likely to be finalised in the course of 2025. PSPs will most likely have to comply from 2026.

Progress of PSD3 has been slightly slower than expected, and somewhat quiet since the election of the European Parliament and formation of the new Commission in the summer.

Besides the points discussed in **last year's briefing**, what has emerged through the course of the legislative process in 2024 is a proposed change impacting on electronic communications services providers (**ECSPs**). The text adopted by the European Parliament in April 2024 includes amendments to Article 59.

Article 59 covers "Impersonation fraud", which would constitute a subset of what in the UK is referred to as authorised push payment fraud (the regime for which was covered extensively in **last year's briefing**, and briefly involves the payer being tricked in some way into authorising a payment to a fraudster). However, what is more eye-catching for "BigTech" about the Parliament's proposals is that ECSPs – essentially telecoms providers and providers of internet platforms within scope of the Digital Services Act – have their own responsibilities, and liabilities, in relation to impersonation fraud.

In particular, where ECSPs are told that their services or platforms are being used to commit impersonation fraud, if they then fail to remove that content, "*they shall refund the payment service provider the full amount of the fraudulent authorised payment transaction under the condition that the consumer has, without any delay, reported the fraud to the police and notified its payment service provider.*" (The PSP would already have borne a liability to the customer.) This goes far beyond anything currently contemplated in the UK (as set out below).

BANK OF ENGLAND CONSULTATION ON FUNDAMENTAL RULES FOR FINANCIAL MARKET INFRASTRUCTURES AND NEW SUPERVISORY APPROACH

WHAT IS THIS? A consultation by the Bank of England on a new set of draft Fundamental Rules, and accompanying supervisory approach, for FMIs.

WHO DOES THIS APPLY TO? UK central counterparties (**CCPs**) and central securities depositories (**CSDs**); and UK-incorporated recognised payment system operators (**RPSOs**) and specified service providers (**SSPs**).

WHEN DOES THIS APPLY? The consultation period is open until 19 February 2025. The Bank has proposed a six-month implementation period between the finalised rules and their entry into force, but the final application date is therefore unknown and could feasibly take place in Q4 2025.

The Bank of England published a package of documents on 19 November 2024 as part of a consultation on a new set of Fundamental Rules for FMIs incorporated in the UK. The Bank stated that these Fundamental Rules will form the core of a broader Bank rulebook for FMIs, which will be developed in due course and replace much of the current legislation directed at CCPs and CSDs.

For CCPs and CSDs, the Fundamental Rules would take effect through the operation of the Bank's rulemaking powers under FSMA 2023, and for RPSOs and SSPs, will apply as binding codes of practice under the Banking Act 2009. The Bank is proposing a six-month implementation period following publication of the final rules, which are, in the Bank's words, "*intended to be comprehensive and transparent…and reflect the high standards that the Bank is seeking across financial and operational resilience, governance and engaging with the Bank.*"

The Fundamental Rules draw heavily on parallel provisions enacted by the FCA and PRA, as follows:

- **FR1**: An FMI must conduct its business with integrity.

- **FR2**: An FMI must conduct its business with due skill, care and diligence.
- **FR3**: An FMI must act in a prudent manner.
- **FR4**: An FMI must maintain sufficient financial resources.
- **FR5**: An FMI must have effective risk strategies and risk management systems.
- **FR6**: An FMI must organise and control its affairs responsibly and effectively.
- **FR7**: An FMI must deal with its regulators in an open and co-operative way and must disclose to the Bank appropriately anything relating to the FMI of which the Bank would reasonably expect notice.
- **FR8**: An FMI must prepare for resolution or administration so, if the need arises, it can be resolved or placed into administration in an orderly manner with a minimum disruption to critical services.
- **FR9**: An FMI must maintain sufficient operational resilience.
- **FR10**: An FMI must identify, assess and manage the risks that its operations could pose to the stability of the financial system.

The Fundamental Rules will apply extra-territorially in all cases (that is, they are not limited to activities carried out in the UK). However, there are two distinctions in how they apply to CCPs and CSDs on the one hand, and RPSOs and SSPs on the other. These differences are due to differences in the scope of the relevant powers held by the Bank. For CCPs and CSDs, Fundamental Rules 3-10 (in the case of FR7, only in so far as it relates to disclosing to the Bank) will apply to their group activities. Fundamental Rules 1 and 2 can only apply on an entity basis. For RPSOs and SSPs, the Fundamental Rules will only apply to the RPSO or the SSP itself. In addition, the instrument implementing the Fundamental Rules for CCPs and CSDs will expressly apply the Fundamental Rules to both regulated and unregulated activities carried out by those FMIs. This was not "*deemed*" to be necessary by the Bank in respect of RPSOs and SSPs.

Alongside the consultation paper and draft Fundamental Rules, the Bank also published a completely new description of its supervisory approach to FMIs, replacing previous documents from 2013 (which covered FMIs and actually pre-dated the finalisation of CSDR) and 2018 (which had a focus on SSPs).

The paper was prompted by the significant changes to the Bank's statutory toolkit and objectives made by FSMA 2023 (and described in our **briefing two years ago**), in particular the addition of a secondary objective to facilitate innovation in the provision of CCP and CSD services with a view to increasing the quality, efficiency, and economy of FMI services, which is subject to advancing the Bank's primary financial stability objective.

The Bank sets out four key principles that guide its supervisory activities and aim to advance the Bank's objectives.

- **Judgement-based**

The Bank uses evidence and analysis to inform the judgements, made by supervisors and validated and challenged, as appropriate, by the Bank's senior and most experienced staff. The Bank stresses, however, that the element of judgement means that there are likely to be occasions where the Bank's supervisory judgement will be different to that of an FMI. Moreover, it acknowledges that there will be times where "*events will show that the Bank's supervisory judgement did not produce the desired outcomes*." (A welcome admission of fallibility.) While there will naturally be a constant dialogue, FMIs "*should not…approach their relationship with supervisors as a negotiation*."

- **Forward looking**

The Bank's aim is not merely to consider current risks, but to assess FMIs against risks that could plausibly arise in the future. This also means that the Bank will look to intervene at an early stage where it perceives an issue.

- **Focused on key risks**

The Bank is led by its financial stability objective. This means that it will always focus its supervision on FMIs and issues that, in its view, pose the greatest risk to financial stability. How the Bank assesses risk is discussed further below.

- **Proportionate**

Connected to the key risk focus is the fact that the frequency and intensity of supervision will be proportionate to the risks posed by the FMI to the Bank's objectives.

The Bank's risk model for supervising FMIs

The starting point for the Bank's judgements is the gross risk, meaning the risk inherent to the FMI's business. This is determined by assessing the potential systemic financial stability impact the FMI could have, taking into account its business model and the external context.

At this stage there is not any assessment of the likelihood of a risk eventuating. FMIs are then placed into one of three cohorts:

- Category 1 – the most significant systems, the failure or manner of operation of which have the capacity to cause very significant disruption to the financial system.
- Category 2 – significant systems, the failure or manner of operation of which have the capacity to cause some disruption to the financial system.
- Category 3 – systems, the failure or manner of operation of which have the capacity to cause, at most, minor disruption to the financial system.

After considering the impact of the external context (relevant factors outside the control of the FMI) and that of the FMI's business model, strategy, structure and the market it serves, the analysis looks at the ways the FMI is **mitigating those risks** through the following lenses (grouped into risk management capabilities and resilience):

- **Management and governance** – this means the effectiveness of the Board and senior management in managing the FMI prudently, consistent with regulatory requirements, expectations and the Bank's financial stability objective. Notably, the Bank emphasises that "*incentives and reward policies and practices for senior executives [must] not create pressure to prioritise revenues, market share and profit over systemic risk management objectives*."
- **Risk management and controls –** this means the FMI's oversight and control of its risks, which requires setting and articulating an appropriate risk appetite and then ensuring that systems and controls are maintained to keep the FMI within that risk appetite. For RPSOs, CCPs and CSDs, this

should also include the risks associated with and/or mitigated by their rulebooks (i.e. how the rules that the FMI imposes on its participants mitigate risks in their own right).

- **Operational resilience –** meaning the ability of the FMI to prevent, detect, respond to, recover and learn from operational disruptions. The centrality of FMIs to so much financial markets activity places an extremely important onus on their operational resilience.

- **Financial resilience –** meaning the FMI's own financial resources and (apart from SSPs) whether the FMI appropriately manages financial risks within its ecosystem. For example, for CCPs this will include their collateral and margin requirements. Capital, liquidity, and financial recovery will all be factors assessed.

- **Preparedness for disruption –** this term (abbreviated to **PfD**), assesses the extent to which the FMI has taken actions to support the Bank in being adequately prepared to mitigate impacts on financial stability if the FMI cannot recover from a financial or operational failure. Recognising that it is not possible to design a structure in which FMIs can never fail, this element interacts with the specific regimes which would apply in the event of a failure (such as the CCP Resolution Regime or the FMI Special Administration Regime).

The output from this analysis is a forward looking (over 12 months) score for each FMI against the Bank's risk tolerance from 1-4, as follows:

1. **Good practice** – the FMI exceeds the Bank's expectations.

2. **Within tolerance** – the FMI's practices comply with the Bank's expectations. There may be some issues that the Bank may raise with the FMI.

3. **Out of tolerance** – there is a risk that the FMI is outside the Bank's risk tolerance. This will require proactive mitigation of those risks by management, with follow-up from the Bank. There may also be a review by a skilled person.

4. **Urgent action** – serious risks have either crystallised or are about to, and the FMI might have breached regulatory requirements. Urgent action, potentially including remediation, is essential.

Proactive intervention framework (PIF)

When determining its supervisory strategy and priorities, the Bank uses the PIF to capture the probability of risks outside the Bank's risk tolerance crystallising over the next 12 months. FMIs with the highest potential impact (the FMI categorisation) and the highest probability of risks crystallising will receive the most intensive supervision.

The Bank does not routinely disclose its PIF judgement to the market or even to the FMI, on the basis that doing so could create a financial stability risk in its own right.

There are five stages to the PIF, set out by the Bank as follows:

1. In tolerance – **low** risk of causing disruption to financial stability.

2. In tolerance – **moderate** risk of causing disruption to financial stability.

3. Out of tolerance – risk of causing disruption to financial stability **without action by the FMI**.

4. Out of tolerance – **imminent** risk of causing disruption to financial stability.

5. In **resolution** or being **wound up**.

Other topics

The paper also includes outlines of the Bank's:

- approach to non-UK FMIs;
- approach to groups;
- supervision of CHAPS;
- approach to reviewing significant changes (with examples);
- co-operation with other UK authorities; and
- activity regarding the Digital Securities Sandbox (covered in **last year's briefing**).

BANK OF ENGLAND ANNUAL REPORT ON FMI SUPERVISION

WHAT IS THIS? A backward-looking review of the Bank of England's activities over 2024 in its capacity as the supervisor of FMIs and an indication of the Bank's future priorities.

WHO DOES THIS APPLY TO? All FMIs subject to Bank of England supervision.

WHEN DOES THIS APPLY? N/A

Immediately before the festive break, the Bank published its Annual Report on FMI supervision, covering the year up to 17 December 2024. Most of the content was a backward-looking review of the Bank's FMI-related activity (and therefore largely out of scope of this briefing); in addition, much of the context-setting replicates content in the Fundamental Rules consultation and the new supervisory approach detailed in the previous item.

However, there are a number of indications, some more concrete than others, about the Bank's plans for 2025.

The Bank's future priorities

Chapter 4 of the report is the most forward-looking, setting out the Bank's FMI priorities as follows:

1. Ensure financial stability through financially resilient FMIs.
2. Ensure FMI services are operationally resilient and not a major financial stability risk in the event of disruption.
3. Enable safe and resilient innovation in payments, settlement and clearing (further detail on this can be found in the section on the National Payments Vision.
4. Implement and embed the Bank's new responsibilities (see below) in a proportionate and robust way.

Repeal and replacement of UK EMIR

The 2023 Annual Report indicated that the Bank was to start work on replacing the assimilated law set out in UK EMIR, and specifically through its transposition from primary legislation into Bank rules. This work appears to have made little obvious public progress, but is now described as a priority, and the Bank states that it aims to consult soon on a set of *"limited policy changes"* with the final rules being in place *"as soon as possible"*. The changes will apparently be focussed on enhancing the resilience of UK CCPs and *"the overall regulatory framework will remain largely unchanged."* In line with HM Treasury's policy in FSMA 2023, moving the regime from legislation to Bank rules will allow for greater flexibility on the Bank's part in the future.

New statutory objectives, considerations, and governance

Given that FSMA 2023 created the new secondary innovation objective for the Bank (*"so far as reasonably possible, facilitate innovation in the provision of CCP and CSD services with a view to improving the quality, efficiency and economy of the services"*), and in the context of the current position of the UK economy, it is not surprising that the Bank carefully lays out how it has and will continue to embed that objective into its work, while acknowledging that it is an iterative process.

FSMA 2023 also required that the Bank have regard to (inter alia) the effect that the Bank's regulation may have on the financial stability of other jurisdictions in which CCPs and CSDs are established or provide services, and the desirability of regulating them in a way that is not determined by whether their users are located in the UK or not.

FSMA 2023 created a statutory Financial Market Infrastructure Committee (**FMIC**) at the Bank, responsible for exercising the Bank's functions with regard to FMIs. With effect from **1 February 2025**, HM Treasury will start to send written recommendations to the FMIC at least once in each Parliament. FSMA 2023 also added a requirement for the Bank to publish its approach to reviewing its rules, and the Bank states that it will publish this consultation in 2025.

Regulatory co-operation

The Bank is working with the FCA to revise their Memorandum of Understanding on FMIs; in addition, the report acknowledges that the MoU on payments (which also includes the PSR) will need to change as a result of the NPV.

Operational resilience

As well as reiterating that FMIs must have taken all reasonable actions to ensure that they remain within their impact tolerances in the event of extreme but plausible disruptions by 31 March 2025, the Bank, along with the FCA and PRA, is consulting on proposals for firms and FMIs to report operational incidents and their third-party arrangements, known as **IOREP**. The Bank's consultation, published on 13 December 2024, is open until **13 March 2025**, so it is possible that the final rules could be published in early summer 2025.

More information is given about the parallel consultations in the section on Operational Incident and Third Party Reporting: FCA Consultation. The procedural substance of the proposals are the same across the different regulators. However, reflecting the different objectives of the regulators, and the industries in which affected firms and FMIs operate, there are some differences and other points of which FMIs should be aware.

- The threshold triggers for FMIs to make notifications to the Bank are linked to the Bank's specific statutory objectives. Notification is triggered when an operational incident could:
    - disrupt the FMI's provision of an important business service (a defined term with which FMIs should already be familiar, as the Bank expressly states) for a prolonged period; or
    - otherwise pose a risk to the stability of the UK financial system.
- The elements of the definition of material third-party arrangement are different for FMIs. For all FMIs and SSPs, it means a third-party arrangement (as set out in the context of the FCA Consultation, this has a wide meaning) a disruption to which could pose a risk to:
    - the continuity of the product or service provided by the FMI or SSP; or
    - the safety and efficiency of the payment system, clearing or securities settlement services provided by the FMI (or supported by the SSP).
- FMIs that do not currently have to deal with the FCA should note that the incident notifications should be submitted using the FCA's Connect system, and the required Register of material third-party arrangements should be submitted using the FCA's RegData system.

Digital Securities Sandbox (DSS)

The DSS, which we discussed in detail in **last year's briefing**, opened for applications on 30 September 2024, with applications for Gate 2 (the go-live stage) opening in November 2024. The Bank's report outlines some of the milestones in 2025:

- **February 2025**: early sandbox entrants gain approval to pass through Gate 2 (it has not been made public how many or which firms have applied).
- **Q4 2025**: First Gate 3 (scaling stage) review point.

Accelerated settlement work

Noting the move (in May 2024) in North American jurisdictions to "T+1" settlement of certain securities trades, the Bank describes accelerating settlement times as "desirable" because of its reduction of counterparty risk and enhancement to liquidity. The Bank then goes on to welcome the recommendations by the Accelerated Settlement Taskforce (made in March 2024 and built upon in September 2024) that the UK move to T+1 settlement by the end of 2027. The Bank also endorses the recommendation that alignment with the EU (ESMA made similar recommendations on 18 November 2024, which will now be considered by the European Commission) be a priority, if possible. (Note that the final report on T+1 settlement in the UK was expected in December 2024; as of 7 January 2025, it had not been published to our knowledge.)

As the supervisor of CSDs, the Bank is clearly a key participant in this programme and will work with stakeholders to establish a realistic timeframe.

Future international work

The Bank anticipates that, in the "near term" there will be some form of consultation following on from CPMI-IOSCO's work on non-default losses in the context of CCPs, and specifically the assessment of the implementation of Principle 15 (general business risk) of the Principles for Financial Market Infrastructures (**PFMIs**).

The Bank emphasises various examples of its collaboration with overseas regulators, in particular in the context of its role as host supervisor of incoming FMIs, including CLS (in respect of which it collaborates with the US Federal Reserve). It also notes its collaboration with the *Nationale Bank van België/Banque Nationale de Belgique* in the context of the Belgian central bank's role as the lead overseer of Swift, and explains that a new legislative framework under Belgian law is being developed, strengthening and broadening the scope of central banks' oversight of Swift, and aligning expectations with the PFMIs. This will ultimately require Belgian legislation, and the timeline is uncertain.

CCP regulation

On 19 December 2024, the Bank published two statements of policy relating to its new powers to supervise CCPs under FSMA 2023:

- Its power to direct a CCP to address impediments to its resolvability.
- Its approach to determining commercially reasonable payments to clearing members whose contracts are subject to a statutory tear-up in CCP resolution.

In both cases the main aspects of the proposals are as previously consulted upon, having received broad support from stakeholders, with some clarifications added.

NATIONAL PAYMENTS VISION

WHAT IS THIS? HM Treasury's publication of a National Payments Vision (**NPV**) in November 2024.

WHO DOES THIS APPLY TO? All PSPs, payment systems, and other participants in the ecosystem (such as merchants and even tech companies).

WHEN DOES THIS APPLY? The NPV is now in train. The Payments Vision Delivery Committee will produce a preliminary plan focussing on retail payments infrastructure (including Pay.UK) by the end of H1 2025, followed by a more detailed Payments Forward Plan by the end of 2025.

Following the publication on 14 November of the National Payments Vision, we **produced** a detailed briefing discussing its impact and implementation.

Two key areas where more detail is needed are preventing fraud and developing Open Banking. The latter is dealt with in the following item.

Fraud

In the case of the former, as our briefing notes, there are strong aspirations to reduce fraud and to involve the payments ecosystem – especially the internet platforms on which much authorised push payment (**APP**) fraud originates – but very little detail as to how that will happen.

Since 7 October 2024, PSPs have been required by the PSR to reimburse victims of APP frauds effected through the Faster Payments Service. This regime was covered in detail in our **briefing last year**. The main development over the course of 2024 was the reduction of the cap on amounts to be reimbursed to £85,000. In addition, the NPV emphasised the PSR's commitment to review the impact of the rules after 12 months. Three months since the rules started to apply, it is too early to draw conclusions either way.

Some firms have criticised the PSR, FCA and HM Treasury, as in their view policymakers have not done enough to widen the burden of preventing fraud, for example by imposing requirements on providers of online platforms or telecoms providers (contrast that with the proposal in the draft PSD3 covered above). What the PSR has done since the NPV is to collate data it gathered from the 14 largest banking groups across Great Britain and Northern Ireland on which platforms their customers tell them that they fall victim to APP scams. On 17 December 2024, the PSR published a report, *Unmasking How Fraudsters Target Customers in the Digital Age.* Perhaps unsurprisingly given its scale and reach, Meta was identified as the organisation whose platforms were cited most often (54% of the volume and 18% of the value of APP scams in scope).

The PSR's report included a figure of £341 million lost to APP frauds in 2023, across eight categories used by the PSR:

- Purchase scams – paying for a good or service that the seller never intended to send.
- Romance fraud – the fraudster feigns a romantic interest and manipulates the victim into sending them money.
- Invoice and mandate fraud – the fraudster sends a false invoice.
- Impersonation scams (bank/law enforcement) – the fraudster impersonates police or bank staff to trick the victim into making a payment.
- Investment fraud – the fraudster convinces the victim to invest in a scheme that does not exist.
- Advance fee fraud – the fraudster persuades the victim to make a payment to secure a later, larger benefit that will not materialise.
- Impersonation fraud (CEO) – the fraudster impersonates a senior workplace figure to induce someone to make a payment.
- Impersonation fraud – other.

The PSR sees this as a first step in widening the burden of fighting fraud.

We expect that the Payments Forward Plan required by the end of **2025** (and discussed in our earlier briefing) will include more work on fraud.

Digital money

In addition, the NPV reiterated the commitment by the Bank and HM Treasury to continue the work on a central bank digital currency (**CBDC**). Since the publication of the NPV, there have been some (unattributed) media rumours that policymakers are becoming less convinced of the need for a CBDC, but there is still expected to be a decision as to whether to approve the launch of a UK CBDC in 2025.

On a related note, while the NPV did no more than mention it, we expect further work in 2025 on the Regulated Liability Network (**RLN**) project. This is an industry-led, collaborative exercise looking at how to use DLT-based innovations such as tokenisation and programmability to create a new type of FMI to process inter-bank payments. Following a successful "experimentation phase", the outputs of which were published by UK Finance in September 2024, there will now be work on:

- Taking forward an orchestration layer with enhanced functionality.
- Further exploring tokenised deposits issued via shared ledger technology.

The ambition is to carry out live pilots by the **end of 2025**. Firms that wish to participate have little time to lose – the deadline to submit expressions of interest is **24 January 2025**.

Future developments in the Bank's Real-Time Gross Settlement (RTGS) service

Alongside the NPV, the Bank has an existing programme looking to upgrade and enhance RTGS. Following a discussion paper published in February 2024, the Bank published a response on 3 October 2024, and Victoria Cleland, the Bank's Executive Director of Payments, delivered a speech on the subject on 5 December 2024. The Bank is clear that is ambition is to offer significantly enhanced availability for RTS and CHAPS settlement, moving towards "near 24x7" towards the end of the decade. Due to the considerable cost of such an enhancement, it will happen in stages. The Bank will publish a consultation paper in 2025 with a detailed assessment of benefits, costs and risks.

FUTURE DEVELOPMENTS ON OPEN BANKING INCLUDING THE DATA (USE AND ACCESS) BILL

WHAT IS THIS? Legislative and regulatory developments intended to develop Open Banking following the NPV.

WHO DOES THIS APPLY TO? All account-servicing payment services providers (**ASPSPs**) and third party providers (**TPPs**).

WHEN DOES THIS APPLY? Unknown.

As described in our **briefing**, one of the most welcome elements of the NPV was the commitment to making account-to-account payments a seamless and "ubiquitous" alternative to payments by card.

Two key workstreams are underway.

Variable recurring payments ("VRPs") – FCA responsibility

The Joint Regulatory Oversight Committee (**JROC**), jointly led by the FCA and PSR, has been leading the work on Open Banking following the CMA's confirmation that its original (competition-focussed) roadmap was complete. The PSR had initiated a project looking at commercial variable recurring payments (covered in **last year's briefing**).

The NPV made clear that the PSR will deliver "phase 1" of VRPs and that from that point, the FCA will be the regulator for Open Banking.

The phase 1 workstream is already underway, looking at three "lower risk" use cases: regulated financial services; regulated utilities; and central and local government. In August 2024, the PSR did publish a paper on the response to its call for views on expanding variable payments. However, that paper mainly illustrated the relative lack of consensus as to how to proceed and a further paper was promised, originally aimed to be in "autumn" 2024. Following the wind-down of JROC and its replacement by the "Open Banking Steering Group", chaired by the FCA, that paper has not yet appeared but is expected imminently. We expect the PSR to finalise the framework for phase 1 in the first half of 2025.

The FCA, as explained, is taking over as the lead regulator for Open Banking, and the NPV gives the FCA a strong steer that phase 2 of the VRP work – e-commerce use cases – should be a priority. We anticipate that the FCA will start a call for evidence and/or consultation process on this in the first half of 2025, although the FCA will doubtless be conscious of the need for co-ordination with the other work overseen by the Payments Vision Delivery Committee established by the NPV (on which the FCA has very senior representation).

Part of the transition from the PSR to the FCA will be a decision on taking forward a multilateral agreement (**MLA**) for VRPs. This would standardise many of the features of the service and avoid the need for TPPs and ASPSPs to form numerous bilateral arrangements. We understand that the FCA is aiming to make an announcement on the MLA, potentially including its choice of the body or bodies that would be responsible for operating the MLA, on **17 January 2025**.

Although the FCA already has certain statutory powers to regulate Open Banking under the PSRs, it is to be given additional powers to make rules that will go beyond existing legislation, potentially forming a new regulatory framework for the evolution of Open Banking. The legislative vehicle the new government intends to use to achieve this is the Data (Use and Access) Bill (the **DUA Bill**). The DUA Bill is currently progressing through the House of Lords and was considered in Grand Committee on 18 December 2024.

The DUA Bill is a wide-ranging and extremely significant piece of legislation on the processing of data in the UK. For present purposes, clause 14 of the DUA Bill empowers HM Treasury to make regulations which in turn give the FCA wide-ranging regulatory powers over Open Banking and Open Finance – but it does not use those terms, and introduces various new concepts (presumably in part to move away from the relatively narrow conception of Open Banking in PSD2 and the CMA Order), including (but certainly not limited to):

- **FCA interface rules** – the term used for the rules that clause 14 empowers the FCA to make.
- **Interface** – a facility or service used, or capable of being used, for providing, publishing or otherwise processing customer data or business data or for taking certain actions in relation to that data.
- **Interface arrangements** – arrangements relating to, or to the use of, an interface.

- **Interface body** – a body that establishes an interface, interface arrangements or interface standards.

- **Interface standards** – standards relating to, or to the use of, an interface.

A provision of particular importance to the sector is clause 15, which includes details on the scope of the FCA's powers to regulate the commercial model. This is important because delivering a sustainable commercial model is absolutely critical to the success of Open Banking. Clause 15(6) permits the making of FCA interface rules that require a fee to be charged "*for the purpose of meeting expenses [incurred, or to be incurred, by an interface body or person acting on its behalf in performing duties or exercising powers under regulations under the DUA Bill or FCA interface rules]*". Clause 15(9)(a) does provide that HM Treasury can empower the FCA to require that the fee exceeds the cost – this is critical because a pure pass-through of certain costs might not sustain a commercial model adequately. This means that firms operating in this space will need to continue to monitor the DUA Bill and lobby accordingly to ensure that the framework is properly constructed.

Given the vital importance of these powers to the ability of the FCA to drive this programme forward, there is a major dependency on the DUA Bill reaching the statute book as swiftly as possible (balancing the need to get it precisely right). The Lords are scheduled to consider the DUA Bill further on both **21** and **28 January 2025**.

FCA SAFEGUARDING CONSULTATION

WHAT IS THIS? Ongoing FCA consultation on material changes to the safeguarding provisions in the e-money and payment services regimes.

WHO DOES THIS APPLY TO? All EMIs and APIs.

WHEN DOES THIS APPLY? Unknown – the consultation period closed on 17 December 2024. The end state regime is unlikely to be in force much earlier than Q4 2026 on the current proposals.

In late 2024, the FCA consulted on a very substantial revamp of the safeguarding regime under the PSRs and EMRs. The consultation – CP24/20 – closed on 17 December 2024 and the FCA aspires to publish the Policy Statement and final rules "in the first half" of 2025.

The safeguarding regime is derived from EU law, so divergence is now possible. The background to the consultation is the FCA's perception that many EMIs and APIs (collectively referred to in this context as **Payments Firms**) are not complying with the safeguarding regime. The FCA has raised the point several times in the recent past, and notes in the consultation paper that the average shortfall (the difference between funds owed to payment service users and funds actually distributed to payment service users in the event of the insolvency of the Payments Firm) in the period Q1 2018 – Q2 2023 was 65%, and that the FCA has active supervisory cases relating to one out of every six firms subject to the rules.

In addition, previous court decisions have rejected the argument that the regime creates a statutory trust over safeguarded funds in favour of payment service users. This was a key element of the FCA's interpretation of the regime.

The FCA proposes a two-stage reform: initially bolstering the existing rules with additional requirements (the **interim state**), before replacing this with a wholly new regime, based on CASS (the **end state**).

Recognising the material nature of the implementation projects that Payments Firms will need to undertake, the FCA proposes that the interim state will become applicable six months after the final rules are published (so potentially in **Q4 2025**).

The end state rules are dependent on HM Treasury's revocation of the existing statutory provisions. This means that the timetable for these rules is not entirely clear, but the FCA stated that Payments Firms will be given 12 months from publication to implement the end state rules, and publication will coincide with that revocation. As a minimum we interpret this to mean that implementation of the end state must be at least 18 months away from the next policy statement: i.e. the publication of the end state rules (which, on the current plan, will trigger the 12-month implementation period for the end state) will not take place before the interim state is in effect. Publication of the end state rules any earlier than that would mean that the implementation periods would overlap.

Although the interim state has been broadly welcomed (or at least accepted) by the industry, the end state has caused a great deal of controversy and resistance, as outlined below. It is a very material change (as the FCA itself recognised) and likely to be costly, especially for smaller firms such as payments fintechs.

Interim state – key features

The interim state has been, and is very much an incremental tightening of some of the governance, transparency and risk management requirements within the current regime:

- Improved books and records
  - More detailed record-keeping and reconciliation requirements for safeguarding, building on existing guidance and similar to existing requirements set out in CASS 7 for investment firms.
  - Payments Firms will be required to maintain a resolution pack, including requirements on the types of documents and records to be included.
- Enhanced monitoring and reporting
  - Payments Firms will have to complete a new monthly regulatory return to be submitted to the FCA covering safeguarded funds and safeguarding arrangements.
  - Compliance with safeguarding requirements must be audited annually by a statutory auditor, with the output of the audit submitted to the FCA.
  - Payments Firms will have to allocate oversight of compliance with the safeguarding requirements to a named individual (note that, at present, the SMCR does not apply to Payments Firms, although the stated policy is to extend the regime to them).
- Strengthening elements of safeguarding practices
  - There will be additional safeguards where Payments Firms invest relevant funds in secure liquid assets.

- Payments Firms will be required to consider the need to diversify the third parties with which they hold, deposit, insure or guarantee relevant funds that they are required to safeguard, alongside heightened requirements on due diligence on these third parties.
- Additional safeguards and more detailed requirements on how Payments Firms can safeguard relevant funds by insurance or comparable guarantee.

End state – key features

- Holding funds under a statutory trust
    - Imposition of a statutory trust over relevant funds held by a Payments Firm, and relevant assets, insurance policies/guarantees (where this is the method of safeguarding used) and cheques (to the extent that the Payment Firm is in possession of any unprocessed cheques).
    - Additional detail around when the safeguarding obligation starts and funds become subject to the trust.
- New approach to safeguarding practices
    - There will be more robust requirements on how Payments Firms must segregate and handle relevant funds. This will include requiring that Payments Firms receive relevant funds directly into an appropriately designated account at an approved bank, except where funds are received through an acquirer or an account used to participate in a payment system.
    - Agents and distributors will not be able to receive relevant funds unless their principal Payments Firm safeguards sufficient funds in designated safeguarding accounts to cover the funds expected to be received and held by their agents or distributors.
    - The diversification aspects of the interim state will be carried forward.

The end state rules have prompted a significant amount of resistance. In particular, the requirement that relevant funds are received directly into a designated safeguarding account is not compatible with the business models of many innovative firms. At present, the obligation to move funds into a designated safeguarding account, or invest into secure liquid assets, arises only once the funds are held at the end of the business day after the day of receipt. Requiring their direct receipt into a designated safeguarding account is going to pose challenges for many businesses and could be unnecessary where funds move through the firm very quickly (such as for money remitters).

Firms are also concerned by the requirement to consider diversification in line with the existing CASS regime. For many smaller Payments Firms, accessing multiple different banks will be difficult, and it is not clear whether it is always proportionate for a firm with relatively low volumes, with an existing relationship with a well-capitalised bank, to need to go into the market to find additional banking partners.

There have been some criticisms of the FCA's cost-benefit analysis, with many firms considering that the work needed for implementation and ongoing compliance have been underestimated. Many non-bank PSPs take the view that the holistic impact on their financial position will be to give banks (which are not subject to the regime where they are executing payments with funds that constitute deposits) a competitive advantage.

Moreover, there is a real question over whether such a far-reaching initiative, carried out seemingly in isolation, is consistent with the direction made in the NPV to streamline and co-ordinate the regulatory agenda for payments.

Impacted firms will need to start planning for the end state position very quickly indeed.

7 FINTECH AND ARTIFICIAL INTELLIGENCE

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
30 December 2024	MiCA	Titles I, II, V, VI and VII enter into force
January 2025	MiCA	Window for CASPs to apply for authorisation in EU Member States opens
2 February 2025	EU AI Act	AI staff literacy requirements, and the ban on prohibited AI practices, will apply
14 March 2025	Future Regulation of Cryptoassets	Deadline for responses to FCA DP24/4 on Admissions & Disclosures and the Market Abuse Regime for Cryptoassets
2 May 2025	EU AI Act	AI codes of practice must be ready
Q1/Q2 2025	Future Regulation of Cryptoassets	FCA to consult on detailed rules on stablecoins; custody; and prudential requirements FCA to publish Discussion Papers on trading platforms; intermediation; lending; staking; and prudential rules for cryptoasset exposures
2 August 2025	EU AI Act	Various elements of the EU AI Act will apply, notably the penalties regime
2 August 2026	EU AI Act	Most of the rest of the EU AI Act will apply, except for general-purpose AI systems already on the EU market before 2 August 2025
Q3 2025	Future Regulation of Cryptoassets	FCA to consult on detailed rules on Admissions & Disclosures and the Market Abuse Regime for Cryptoassets; and conduct and firm standards for new RAO activities
"In" 2025	Central Bank Digital Currency (covered in Future Regulation of Cryptoassets)	Expected decision by HM Treasury on whether to launch a UK CBDC
Q4 2025/Q1 2026	Future Regulation of Cryptoassets	FCA to consult on detailed rules on trading platforms; intermediation; lending; staking; and remaining prudential rules

1 July 2026	MiCA	All CASPs and issuers of ARTs and EMTs must comply with MiCA (latest possible date) Grandfathering period for pre-existing CASPs closes

ITEMS COVERED IN THIS SECTION

MARKETS IN CRYPTOASSETS REGULATION (MiCA): A REMINDER

WHAT IS THIS? The entry into force of the remaining titles of the EU's comprehensive legislative framework on the regulation of cryptoassets.

WHO DOES THIS APPLY TO? All cryptoasset businesses operating in the EU or with EU clients.

WHEN DOES THIS APPLY? 30 December 2024.

At the very end of last year, the final set of MiCA provisions took effect. As our **briefing last year** noted, the provisions on asset-referenced tokens (**ARTs**) and electronic money tokens (**EMTs**) have been applicable since the middle of 2024. Issuers of ARTs and EMTs have therefore been grappling with the requirements for some time.

Issuers of unbacked cryptoassets (i.e. those which are neither ARTs not EMTs) will now have to comply, as will cryptoasset service providers (**CASPs**). These are defined as businesses carrying out the following activities:

- custody and administration of crypto-assets on behalf of clients;
- operating a trading platform for crypto-assets;
- exchanging crypto-assets for funds within the meaning of MiCA or for other crypto-assets;
- executing orders for crypto-assets on behalf of clients;
- placing of crypto-assets;
- reception and transmission of orders for crypto-assets on behalf of clients;

- advising on crypto-assets;
- portfolio management on crypto-assets; and
- providing transfer services for crypto-assets on behalf of clients.

Critically, existing CASPs (which, a little confusingly, are often referred to, for example in FATF publications, as virtual asset service providers, or **VASPs**) are permitted to continue operating in the EU for 18 months without authorisation – new market entrants will have to obtain authorisation first.

EU AI ACT

WHAT IS THIS? The implementation of the EU's landmark legislation governing Artificial Intelligence, Regulation (EU) 2024/1689 (the **EU AI Act**).

WHO DOES THIS APPLY TO? All businesses providing, importing, deploying, or distributing (note that these terms have specific meanings) AI systems in or into the EU.

WHEN DOES THIS APPLY? The Regulation entered into force on 2 August 2024. There is a phased implementation which begins for certain requirements (see below) on 2 February 2025. Most provisions will be applicable from 2 August 2026, although for certain systems that were on the market before 2 August 2025, there are grandfathering provisions that give those businesses until 2 August 2027 to comply.

The EU AI Act entered into force on 2 August 2024. Although most of the provisions will apply to in-scope institutions from either **2 August 2025** or **2 August 2026**, there is a rapidly approaching and urgent deadline of **2 February 2025**.

This is the date when two important sets of provisions will begin to apply:

- **Staff AI literacy requirements (Article 4)**

Providers and deployers (explained below) must ensure that their staff using AI have "AI literacy", taking into account the context (including the people, such as clients or other employees, who may be impacted by this use of AI). "AI literacy" is defined as "*skills, knowledge and understanding that allow providers, deployers and affected persons…to make an informed deployment of AI systems, as well as to gain awareness about the opportunities and risks of AI and possible harm it can cause*".

In practice, if not already in train, for many this will require urgent staff training and internal communications in order to upskill relevant staff.

- **Prohibited AI practices (Article 5)**

Article 5 consists of a lengthy list of AI practices that will be banned in the EU from 2 February 2025. Press coverage has focussed on aspects such as the ban on scraping the internet or CCTV to build or expand facial recognition databases, but the legislation also includes bans on systems that are designed to manipulate individuals at a subliminal level without their ability to perceive this; systems that build so-called "social scores" with real world impacts; and systems designed to predict criminal activity.

Scope and key concepts

The EU AI Act divides the ecosystem into four cohorts:

- **Providers** are those that develop AI systems and place them on the market or put systems into service in the EU under their own name or trademark, whether for payment or free of charge.

- **Deployers** covers any person, public authority, agency or other body using an AI system under its authority except where the AI system is used for personal, non-professional activities. We would expect any EU clients using AI to fall within this cohort at the very least.

- **Importers** means any person located or established in the EU that places on the market an AI system that bears the name or trademark of a person established outside the EU.

- **Distributors** are any person in the supply chain, **other than** the provider or the importer, that makes an AI system available on the EU market.

Providers are subject to the most onerous requirements, and are also caught irrespective of their location. Importantly, in the context of high-risk AI systems, parties that most obviously look to be deployers, importers or distributors can be deemed to be providers in certain circumstances (i.e. attracting additional obligations).

Territorial application

The EU AI Act is expressly extra-territorial in certain ways:

- Those meeting the definition of a provider are caught even if they are established or located outside the EU.

- Where the *output* of the AI system is used in the EU, then providers and deployers of that AI system will be caught, even if they are established or located outside the EU.

- Providers established outside the EU are obliged to appoint an "authorised representative" inside the EU, to carry out certain functions on their behalf.

Other points to note include that the EU AI Act:

- applies to "AI systems", which is defined very broadly as meaning "*a machine-based system designed to operate with varying levels of autonomy and that may exhibit adaptiveness after deployment and that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments*";

- imposes various requirements on providers of general purpose AI systems, which are defined as AI that "*displays significant generality and is capable to competently perform a wide range of distinct tasks*"; and

- imposes a further set of obligations (notably on risk mitigation and cybersecurity) on providers of a subset of general-purpose AI systems known as "general-purpose AI systems with systemic risk", meaning those with high-impact capabilities.

Other 2025 milestones

Many (but not all) of the 2025 milestones are mandates aimed at EU institutions and Member States.

By **2 May 2025**, the "AI Office" (essentially a new regulator) must facilitate the production of codes of practice for various aspects of AI use (which will involve consultation with market participants).

By **2 August 2025**, Member States are required to have taken various actions and made certain notifications.

From the perspective of firms, the two key elements of the regime in place from **2 August 2025** are the penalties regime (as is typical of much EU legislation, the penalties can be very severe, especially for global businesses, with the maximum being the higher of €35 million or 7% of global annual turnover) and the rules on general-purpose AI systems that are not already on the EU market as of that date.

It is possible that providers of general-purpose AI systems will rush new products to market before the 2 August 2025 milestone in order to gain the extra two years with which to comply with the rules, which in the very short term arguably accelerates the "AI arms race".

Currently, the UK has no express plans to introduce an equivalent standalone framework, and the approach has been to allow sectoral regulators to examine how AI interacts with the regimes for which they are responsible, plus existing law (such as data protection). However, we consider it likely that some form of overarching regulation will be introduced at some stage, albeit in a more targeted form than the EU AI Act.

PROPERTY (DIGITAL ASSETS ETC) BILL AND ASSOCIATED DEVELOPMENTS

WHAT IS THIS? A draft Bill before the House of Lords, drafted by the Law Commission, which seeks to confirm that digital assets (and potentially other types of assets) are capable of being personal property for the purposes of English law. There has also been a recent case concerning the status of digital assets as personal property – *Fabrizio D'Aloia v Persons Unknown & Others* – in the High Court.

WHO DOES THIS APPLY TO? N/A

WHEN DOES THIS APPLY? The Bill could enter into force in 2025.

We have previously covered these and associated developments in detail in two existing briefings:

- *The Law Commission's approach to digital assets as property: the devil is in the detail.*
- *Victory in Victoria.*

The Bill continues to proceed through the House of Lords. The Special Public Bill Committee considering it has taken both oral and written evidence over the course of November and December 2024 and may schedule further oral evidence in the early part of 2025. It seems relatively unlikely to reach the House of Commons before the end of **Q1 2025**.

The Law Commission will also continue its work on the private international law aspects of digital assets, on which it published a call for evidence in February 2024. Responses were due in May last year. While this could mean that the Law Commission publishes some form of consultation in 2025, the role of Commissioner for Commercial and Common Law has been vacant since September 2024, and the process to identify Professor Sarah Green's successor is ongoing. This factor, along with the greater than expected divergence of opinion on the Bill, and the amount of work being done at international level (for example, by UNIDROIT and the Hague Conference on Private International Law) could see this workstream pushed into 2026.

Given the global nature of the digital assets markets (including markets for tokenised 'real-world assets'), this project is of real importance to digital assets businesses and should not be regarded as an academic exercise.

FUTURE REGULATION OF CRYPTOASSETS IN THE UK

WHAT IS THIS? HM Treasury announcement that the Government will continue with the previous Government's policy approach to cryptoasset regulation and the FCA's proposed next steps.

WHO DOES THIS APPLY TO? All cryptoasset businesses and their investors in the UK.

WHEN DOES THIS APPLY? Full regime expected to go live in 2026.

One of the areas thrown into the greatest confusion by the General Election in July 2024 was the regulation in the UK of cryptoassets. The previous Government (as covered in **last year's briefing**) had announced that cryptoassets would be brought into the regulatory perimeter. Rather than adopting the EU's approach in MiCA of creating a new bespoke regime, the UK's approach would be to bring the sector into the existing regulatory regime, albeit with regulators looking to tailor it as appropriate. The previous Government proposed a phased approach, with "phase 1" consisting of the regulation of activities relating to fiat-referenced stablecoins (which would include amending the payment services regime to cover these stablecoins when used for payments), "phase 2" being the extension of the regulatory perimeter to cover broader cryptoasset activities, and a possible additional phase looking at activities specific to cryptoassets, such as staking.

The previous Prime Minister, Rishi Sunak, was an enthusiastic advocate for the UK as a "hub" for the digital assets industry, but the attitude of many new Labour MPs was not clear. As a result, many in the sector were eager to hear what approach would be taken. In particular, the preparatory work for phase 1 on stablecoins had commenced, with the FCA and Bank of England publishing discussion papers in November 2023 – now over a year ago.

On 21 November 2024, Tulip Siddiq, the Economic Secretary to the Treasury (often described as "the City minister") announced the outcome: HM Treasury is to continue the policy of bringing cryptoassets into the FSMA regime, *but* without the specifically phased approach laid out by the last Government, and – critically – without taking forward the proposals to amend the payment service regime to cover fiat-referenced stablecoins used in payments.

The minister explained the Government's view was that "*[d]oing everything in a single phase is simpler, and it just makes more sense.*" On the other hand, bringing stablecoins into UK payments regulation "*would place additional regulatory burdens on certain stablecoin activities in a way that would not be proportionate based on the current use cases.*"

As noted in the entry on the NPV above, we continue to expect a decision on whether to seek to launch a UK CBDC from HM Treasury and the Bank this year.

FCA Crypto Roadmap

The FCA wasted little time in putting forward its response, publishing the FCA Crypto Roadmap on 26 November 2024. While HM Treasury has moved away from the phased approach, in practice the FCA is not going to deliver the entire piece of work as a monolithic whole.

Stating that being transparent about its plans was intended to help stakeholders plan and resource their projects, the Crypto Roadmap sets out a series of high-level milestones (subject to change and with a dependency in some areas on legislative activity, such as changes to the Regulated Activities Order), working towards the publication of all final rules in 2026 (and presumably relatively late in 2026, as some important areas may not see draft rules until early 2026). We expect that there will then be both some form of implementation period, as well as a gateway for existing firms that will then need FCA authorisation to apply.

The Roadmap is summarised below:

Indicative dates	Discussion Papers	Consultation Papers
Q1/Q2 2025	**Trading platform rules** including location, access, matching and transparency requirements **Intermediation rules** including order handling and execution requirements **Lending rules** including ownership, access and disclosures **Staking** including ownership and disclosures **Prudential considerations** for cryptoasset exposures	**Stablecoins** • Backing assets • Redemption **Custody** • Recordkeeping • Reconciliations • Segregation of assets • Use of 3rd parties **Prudential** • Introduction of a new prudential sourcebook, including capital, liquidity and risk management

Q3 2025		**Conduct and firm standards for all RAO activities** • Systems and controls including Operational Resilience and Financial Crime • Consumer Duty • Complaints • Conduct (COBS) • Governance including SMCR **Admissions & Disclosures** **Market Abuse Regime for Cryptoassets**
Q4 2025/Q1 2026		**Trading platform rules** **Intermediation rules** **Lending rules** **Staking** **Resolution** **Remaining material for prudential source book** • Groups • Reporting

DP24/4: Admissions & Disclosures (A&D) and Market Abuse Regime for Cryptoassets (MARC)

Moving very rapidly to the execution of that roadmap, on 16 December 2024 the FCA published DP24/4, the first discussion paper on two aspects of the new regime: A&D and MARC. This is open for responses until **14 March 2025**. The discussion paper sets out the key risks that the FCA is seeking to mitigate and the outcomes it is aiming to achieve, noting that in a number of ways many cryptoasset markets may not operate in the same way as markets for traditional financial instruments.

USE OF ARTIFICIAL INTELLIGENCE IN INVESTMENT MANAGEMENT

WHAT IS THIS? A report from the Investment Association's Technology Working Group on current and future usage of AI in the investment management industry.

WHO DOES THIS APPLY TO? Any investment management firm making use of AI.

WHEN DOES THIS APPLY? Recommendations aim for delivery between 6 and 18 months from publication.

In October 2024, the Technology Working Group (the **Group**) of the Investment Association published a Final Report on the current and future use of AI by investment management firms. Although not exclusively focussed on retail investments, the Group is aligned more to regulated investment funds than to alternative asset managers.

The Group (which has also published outputs on fund tokenisation and expressly says that it sees DLT and AI as the two most critical technologies for the industry), while industry-led, includes HM Treasury and the FCA as observers (and indeed the Report included forewords from the Economic Secretary to the Treasury and the FCA's Executive Director for Markets and International).

The Report is also important when looked at in the broader context of AI in financial services. On 21 November 2024, the Bank of England and FCA jointly published their paper *Artificial intelligence in UK financial services – 2024.* While this is a descriptive paper outlining the results of the regulators' research into use of, and attitudes to, AI across the regulated sector, it clearly helps to deduce regulatory priorities. For example, the three risks that are expected to increase the most over the next three years are third-party dependencies, model complexity, and embedded or 'hidden' models – all priorities for regulators.

The Report concludes the formal work of the Group and includes seven recommendations:

- **Skills and talent:** The Government should strengthen its commitment to promote computer science, data science, software engineering and related fields in colleges and universities, as well as building better connections between industry and post-16 education providers. The timeline for this is seen as being 1-2 years.

- **Regulation:** The Group is supportive of the current UK direction of travel on regulating AI, and emphasises the need for clarity and certainty, as well as recommending that the UK continue to take the lead on ensuring international alignment and co-ordination. Timeline: 1-2 years.

- **Malicious actors:** The public and private sectors should work together to counter AI-enabled fraud, cybercrime and misinformation. The understanding and mitigation of the risks from malicious actors should be a focus. Timeline: 1-2 years.

- **New systemic risks:** The Group supports the activity of the Bank of England's Financial Policy Committee in highlighting potential systemic risks and welcomes the CTP regime covered elsewhere in this briefing (see below). The Group also notes that the emergence of new systemic risks should encourage rather than discourage innovation. Timeline: 1 year.

- **AI risks and governance:** The IA aims to produce detailed guidance for the industry on AI risk and governance. AI risk management is identified as a priority. Timeline: 6-12 months.

- **Legal uncertainties:** These are considered likely to remain an issue for some time. However, the IA is committed to producing benchmarking, best practice guidance, and ethical frameworks and recommends that the industry increase their efforts in this area. Timeline: 1-2 years.

- **UK Fintech Ecosystem:** The IA has an accelerator-style programme called the Innovator Programme, which was open for applications from fintechs until 21 November 2024. The IA will continue to foster connections between fintechs and the investment management sector. Timeline: 6-18 months.

Current use cases

The Report also describes at a high level five early-stage case studies for AI use cases:

1. "General purpose" co-pilot.
2. Enhanced ESG reporting.
3. Sales and client assurance (meaning producing first draft responses to requests for proposals and so on).
4. Regulatory compliance (i.e. ingesting regulations and then review documents such as policies against the requirements).
5. Responding to client service messages.

Internal AI risk management

The Report includes a helpful appendix looking at different types of risks. These are divided into three groups: those arising from the AI model itself or the data used to train it; those from external factors; and those from within the firm.

Data and AI model risks

<table>
<tr><th>Risk</th><th>Potential mitigants</th></tr>
<tr><td>AI systems rely on outdated or misleading data, leading to inaccurate outputs</td><td rowspan="4">• Creating controls and safeguards
• Transparent and explainable AI
• Scope control
• Data verification procedures
• Third party checks</td></tr>
<tr><td>LLMs produce plausible sounding but incorrect outputs</td></tr>
<tr><td>LLM outputs are probabilistic in nature rather than deterministic</td></tr>
<tr><td>Models may become less accurate over time</td></tr>
</table>

<table>
<tr><td>External AI models may collect and misuse proprietary or personal data</td><td rowspan="4">Thorough review and collaboration
Clear disclosure guidelines</td></tr>
<tr><td>AI models are complex and that the firm is then unable to demonstrate how decisions are made</td></tr>
<tr><td>AI models amplify any bias in the data and discriminate towards or away from a particular group of people or a specific outcome</td></tr>
<tr><td>Consumers are not informed that AI has been used in processing their data/providing an output to them</td></tr>
</table>

External risks

<table>
<tr><th>Risk</th><th>Potential mitigants</th></tr>
<tr><td>Data breaches or unauthorised access can result in proprietary data loss</td><td rowspan="6">Effective regulatory framework
Assessing cybersecurity risks
Comprehensive risk register
External threat-aware personnel
Third party oversight</td></tr>
<tr><td>AI is used to develop sophisticated cyberattacks on firms</td></tr>
<tr><td>Vulnerabilities in AI systems can be exploited by bad actors for malicious intent</td></tr>
<tr><td>Third parties utilise AI models that acts on a firm’s behalf without sufficient oversight/permission</td></tr>
<tr><td>Third parties rely on AI in a way that impacts service quality, reliability or resilience</td></tr>
<tr><td>Unchecked AI presents unexpected or novel opportunities for litigation</td></tr>
</table>

Internal risks

<table>
<tr><th>Risk</th><th>Potential mitigants</th></tr>
<tr><td>Insufficient staff expertise and/or training can lead to lack of understanding or failure to realise the upsides of AI</td><td rowspan="4">• Implement robust governance frameworks for use of AI including data handling
• Investing in employee training
• Test business uses of AI safely
• Innovative education and engagement initiatives
• Continuous monitoring</td></tr>
<tr><td>Sub-optimal outcomes for customers or other external impacts result in reputational damage for the firm</td></tr>
<tr><td>Personal individual identifiable information is lost during HR or customer data processing</td></tr>
<tr><td>Understanding of where and how AI is used is lost as more use cases are deployed and/or roll-out becomes uncontrolled.</td></tr>
</table>

8 ORGANISATIONAL

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
1 January 2025	UK Critical Third Parties regime	The rules and policy from the Bank of England, PRA and FCA come into force.
17 January 2025	EU DORA	The new regime applies.
13 March 2025	UK operational resilience and third party reporting regime	FCA consultation paper on operational incident reporting and material third party reporting requirements closes.
31 March 2025	EU DORA	Deadline for EU national competent authorities to submit lists of financial entities identified as systemic to ESAs (with the exception of credit institutions).
30 April 2025	EU DORA	Deadline for EU national competent authorities to submit registers of information (compiled from information supplied by firms) to the ESAs.
H2 2025	EU DORA	ESAs expect to make first designations of critical ICT third-party service providers.
H2 2025	UK operational resilience and third party reporting regime	Publication of FCA's finalised rules on operational incident reporting and material third party reporting requirements.

ITEMS COVERED IN THIS SECTION

DORA: EU DIGITAL OPERATIONAL RESILIENCE ACT: A REMINDER

WHAT IS THIS? The EU Regulation on Digital Operational Resilience, setting out ICT security requirements for financial services firms and oversight of certain third parties providing ICT services to them.

WHO DOES THIS APPLY TO? EU financial services firms and third-party ICT service providers.

WHEN DOES THIS APPLY? 17 January 2025 for in-scope financial entities. No critical third-party ICT service provider has yet been designated (the first designations are expected in H2 2025).

In a matter of days, on **17 January 2025**, and with the relevant technical standards and guidelines now in place, the EU Regulation on Digital Operational Resilience will start applying with direct effect in Member States. Member States are also required to transpose the related amending Directive by the same date. For example, Luxembourg transposed the Directive into its national law on 1 July 2024 (to be effective as of 17 January 2025).

On 4 December 2024, the Joint Committee of the European Supervisory Authorities (the **ESAs**) issued a statement entitled DORA application calling on financial entities and third-party providers to "advance their preparations to ensure their readiness". Among other things, this short statement reminds financial entities that:

- They are expected to conduct a gap analysis between their existing internal operations and the DORA requirements.
- They must prepare for the new reporting obligations – in particular they must have their registers of the contractual arrangements with their ICT third-party providers available for competent authorities "early in 2025". This is because the competent authorities have a deadline of 30 April 2025 to onward report them to the ESAs.

Those ICT third-party service providers who believe they meet the criticality criteria set out in Commission Delegated Regulation (EU) 2024/1502 are also encouraged to assess their operational processes and procedures against the DORA requirements. The first designation of *critical* third party providers in accordance with those criticality criteria is expected in H2 2025.

To help EU regulated asset management and fund management firms (and their groups) understand – and comply with – the governance and contractual compliance requirements that will apply to them, we have put together a **DORA Pack** – this includes a set of introductory, training slides, a project plan, a checklist of the various governance requirements, template implementation minutes (board or management committee), a template register of contractual arrangements, a contractual compliance review template and a template DORA amendment side letter.

If you are interested in knowing more, we can provide you with a **brochure** on request which explains what entities the package is designed for, what it covers and pricings. Please speak to your usual contact at Travers Smith for more details.

UK CRITICAL THIRD PARTIES REGIME: REGULATORS' FINAL RULES

WHAT IS THIS? The final rules and policy from the Bank of England, PRA and FCA on how they will regulate critical third parties (**CTPs**) which are designated by HM Treasury. Note: "CTP" is the abbreviation for "critical third party" used in the Regulators' materials; in an entirely different context, HM Treasury uses "CTP" as an abbreviation for "consolidated tape provider".

WHO DOES THIS APPLY TO? Directly relevant to the designated CTPs as "providers", wherever located; also of interest to firms and FMIs as "users" of CTP services.

WHEN DOES THIS APPLY? The rules came into force on 1 January 2025. They will apply to individual CTPs as and when designated by HM Treasury. At this time, no Designation Order has yet been made.

In November 2024, the supervisory oversight framework for the UK's critical third parties regime was settled with the publication of the final set of rules, policies and supervisory statements from the Bank of England, the PRA and the FCA, the front-line regulators who will – in due course – find themselves directly supervising entities that may not have been subject to financial services regulation to date. The new rules came into force on **1 January 2025** and will apply to each entity designated by HM Treasury as a CTP, with effect from the date on which each relevant Designation Order is effective. At the time of writing no Designation Order has yet been made.

In the beginning at least, the most obvious targets are likely to be a small handful of the very biggest global technology entities which provide cloud services to UK firms and FMIs. It is a major disruption to their services and/or operations which would most immediately pose a significant threat to the stability of the UK financial system and it is likely that the Regulators will want to "test" how the settled regime beds in with a small number of CTPs from the outset. But, perhaps less immediately, others may be in the frame because of their perceived, but less obvious, systemic importance: so it may not simply be the "usual suspects" that the supervisors are worried about. That said, third party service providers which are subject to other regulatory oversight regimes that are subject to a level or regulation and oversight that provides at least equivalent outcomes to the ones that the Regulators are looking for (such as telecommunications or energy providers) may escape designation. Time will tell.

A reminder: the new CTP regime – regulatory consultation

As we reported in **Financial Services Regulation 2024 - New Year briefing | Travers Smith** and our subsequent briefing **Situation critical: proposed new rules to regulate Critical Third Parties | Travers Smith**, the Bank of England, FCA and PRA (the **Regulators**) had consulted back in December 2023 on new rules and a joint Supervisory Statement on their powers to regulate critical third parties that have been designated by HM Treasury. Consultation closed in March 2024. These powers derive from the Financial Services and Markets Act 2023 (for the background to the statutory underpinning of the new regime, see Section 3 of our briefing

Financial Services and Markets Act 2023: Building a Smarter Regulatory Framework in the UK? | Travers Smith).

HM Treasury guidance on its approach to designation

In March 2024, HM Treasury published its Approach to Designating Critical Third Parties. Generally, HM Treasury said that it expects to make designations of CTPs on the basis of recommendations made by the financial regulators (although it will remain possible for it to designate on its own initiative without such a recommendation). Overall, it anticipated that each recommendation will take around six months to process, following the indicative procedure below:

Process	Action	Timing
Receipt of recommendation	• HMT considers whether there is merit in the regulators' recommendation • HMT writes to prospective CTP to open period for formal representations • Prospective CTP is invited to send formal representations • HMT consults the financial regulators and, where appropriate, will also consult wider organisations	3 months
Representations	• Period for formal representations ends	
Considerations and Decision	• HMT considers all evidence and representations • HMT makes final designation decision • HMT informs prospective CTP of outcome • HMT makes and publishes the Designation Regulations (if it has decided to designate)	3 months

Following on from the above, if it has decided to proceed with the designation, HM Treasury will indicate which of the relevant services are deemed to be material. It will then proceed to make the statutory instrument – i.e. the Designation Regulations. Each statutory instrument will be published on legislation.gov.uk.

The Regulators' final rules and policy

On 12 November 2024, the Regulators published PS16/24 – Operational resilience: Critical third parties to the UK financial sector | Bank of England, a joint policy statement setting out feedback to the responses they had received to third consultation and confirming their final policy. The following documents are appended to the policy statement:

- The Regulators' final rules for CTPs set out in the Bank of England FMI Rulebook, the PRA Rulebook and the FCA Rulebook:
    - Bank of England FMI Rulebook: Critical Third Parties instrument 2024
    - Bank of England FMI Rulebook: Critical Third Parties Emergency Provisions Instrument 2024
    - PRA Rulebook: Critical Third Parties Instrument 2024
    - FCA Handbook: Critical Third Parties Instrument 2024
    - FCA Handbook: Critical Third Parties Statement of Policy relating to Disciplinary Measures Instrument 2024
- Joint Supervisory Statement SS6/24: Operational resilience: Critical third parties to the UK financial sector.
- PRA Supervisory Statement SS7/24: Reports by skilled persons: Critical third parties.
- The Joint Regulators' approach to the oversight of critical third parties – this includes the criteria the regulators' will apply for identifying potential critical third parties and recommending them to HM Treasury for designation (the **Regulators' CTP Approach document**)(see HM Treasury's Approach to Designating Critical Third Parties above).
- The Bank of England's approach to enforcement: changes to statements of policy and procedure following the Financial Services and Markets Act 2023.

This final package of measures is primarily relevant to those CTPs that will be designated by HM Treasury, since they will be directly and exclusively subject to the new requirements and regulatory expectations. While the CTP regime does not impose any new or additional requirements on firms and FMIs, it nonetheless "complements" the existing rule requirements and regulatory expectations relating to operational resilience and third party risk management and, if a firm is a "user" of CTP services, it pays to understand the requirements to which the provider of those services will be subject.

Preventing the halo effect

It is also important, however, that such firms do not misunderstand what CTP designation means and see it as some kind of regulatory badge of approval or endorsement, thereby skimping on the obligations that apply to them when selecting and using the CTP. The "fact that a third party has been designated as a CTP by HMT does not mean that it is inherently more resilient or better suited to provide one or more services to a given firm than a non-designated third party providing the same or similar services". The CTP itself must not indicate or imply in any way that it has the Regulators' approval or endorsement by virtue of its designation and supervision.

Scope of CTP regime and territoriality – a reminder

The statutory test for designation by HM Treasury is set out in section 312L FSMA. Section 312L(1) empowers the Treasury to make regulations designating a person who provides services to one or more authorised persons, relevant service providers (electronic money institutions and authorised payment institutions) or FMI entities (broadly, recognised clearing houses, CSDs, UK recognised investment exchanges) as a critical third party. Section 312L(2) makes it clear that the regime is designed to capture only those third parties whose provision of services (either individually or, where more than one service is provided, taken together) could, in the event of a failure or disruption, threaten the stability of, or confidence in, the UK financial system. So, in terms of territoriality, the service "user" in all cases must be a UK firm or FMI and the threat to the stability of or confidence in the UK financial system is key. However, subject to that UK focus, the CTP regime will apply irrespective of the location of the CTP and/or its operational facilities.

Proportionality

A common theme in the feedback from respondents to the December 2023 consultation was the need for proportionality in the rule requirements and regulatory expectations, and in the way in which the CTP oversight regime is to be implemented. The Regulators took this on board, and a number of changes throughout the final rules, the joint Supervisory Statement SS6/24 and the Regulators' CTP Approach Document reflect a more proportionate approach, recognising that designated CTPs may come in different shapes and sizes.

The Regulators' CTP Approach Document

The Regulators have added additional guidance on their approach to identifying CTPs and recommending them for designation to HM Treasury. This document sets out in detail the criteria the Regulators will use for identifying potential CTPs and recommending them to HM Treasury for designation (as HM Treasury acknowledges in *its* Approach document for the most part it expects to make designations of CTPs on the basis of recommendations made by the Regulators). This includes the Regulators' assessment of materiality: the Regulators' CTP Approach Document makes the point that the Regulators' assessment of the *systemic* materiality of a third party's services for the purposes of identifying potential CTPs is informed by, but may differ from, the test of materiality that firms may adopt in assessing the materiality of their outsourcing and third party arrangements.

Defined term – "material services" becomes "systemic third party services"

In our briefing **Situation critical: Proposed new rules to regulate Critical Third Parties | Travers Smith** we noted that, in consultation, the Regulators' use of the term "material services" was substantially the same as the statutory test for HM Treasury designation and that curiously, what that meant in practice, was that once designated, part of the new CTP regulatory framework would appear to apply across the CTP's entire business, with heightened requirements attaching to the services that mainly prompted designation.

As mentioned above, the Regulators have introduced the concept of proportionality in a number of places, a good example being the limitation in the scope of the CTP fundamental rules (see below). Furthermore, in the final rules, among other changes to key defined terms, the Regulators have renamed "*material services*" (as used throughout the rules) to "*systemic third party services*" to "better reflect the systemic risks posed by the potential disruption or failure of these services". Despite the name change, the definition itself is substantially the same as the definition of "material services" in the consultation – i.e. "a service (wherever carried out) provided by a critical third party to one or more firms a failure in, or disruption to, the provision of which (either individually or, where more than one service is provided, taken together) could threaten the stability of, or confidence in, the UK financial system".

This name change helps to distinguish between the Regulator's concept of *systemic* materiality for the purposes of the CTP regime from an individual firm's assessment of a third party service provider as being material for its own operational resilience. The two may, of course, overlap in a number of cases, but just because a firm rightly assesses a third party provider as material for its own operational resilience does not necessarily mean that the Regulators will see those services as threatening UK financial stability generally.

CTP Fundamental Rules – a limitation in scope and clarifications

The six CTP fundamental rules are recognisably derived from the FCA Principles for Business and the PRA Fundamental Rules:

- *CTP Fundamental Rule 1*: A CTP must conduct its business with integrity.
- *CTP Fundamental Rule 2*: A CTP must conduct its business with due skill, care and diligence.
- *CTP Fundamental Rule 3*: A CTP must act in a prudent manner.
- *CTP Fundamental Rule 4*: A CTP must have effective risk strategies and risk management systems.
- *CTP Fundamental Rule 5*: A CTP must organise and control its affairs responsibly and effectively.
- *CTP Fundamental Rule 6*: A CTP must deal with a regulator in an open and co-operative way, and must disclose to a regulator appropriately anything relating to the CTP of which it [the regulator] would reasonably expect notice.

In consultation, the Regulators had proposed that all six Fundamental Rules would apply to *all* services provided by a CTP to firms and FMIs, regardless of whether those services were material or not. However, based on feedback to the effect that this was disproportionate, the regulators have cut back the scope of the CTP Fundamental Rules as finalised. Now, CTP Fundamental Rules 1 – 5 above will apply specifically to a CTP's provision of "*systemic third party services*" (previously "material services" (see above)); only CTP Fundamental Rule 6 will continue to apply in relation to *all* the services that a CTP provides to firms. However, the regulators say that they will be keeping this limitation on scope under review.

The Regulators also took the opportunity to provide some clarification on how a CTP should interpret and comply with certain requirements under the CTP Fundamental Rules – for instance, the concepts of "acting in a prudent manner" (as required by CTP Fundamental Rule 3) and "disclosing to the regulator appropriately anything relating to the CTP of which it would reasonably expect notice" (as required by CTP Fundamental Rule 6).

CTP Operational Risk and Resilience Requirements

The above CTP Fundamental Rules are supplemented by eight extensive and detailed additional requirements on operational risk and resilience. These expressly apply in each case to "systemic third party services" and are summarised as below:

- *Requirement 1: Governance* – a CTP must ensure that its governance arrangements promote the resilience of any systemic third party service it provides. This includes, among other things, appointing an individual with the appropriate authority, knowledge, skills and experience to act as the central point of contact with the Regulators. That person must be an employee or member of the governing body of the CTP. SS6/24 sets out more detailed regulatory expectations, including that the relevant individual should be contactable at all times during UK business hours and, outside UK business hours, as required during a CTP operational incident, regardless of whether they are located in the UK or not. This is perhaps in recognition of the fact that some CTPs, when designated, may well not be UK entities and may not even have a UK presence; in cases such as this, the nominated individual will need to be contactable by the Regulators, whatever time of day it is in their jurisdiction.

- *Requirement 2: Risk management* – a CTP must manage effectively the risks to its ability to continue to deliver a systemic third party service.

- *Requirement 3: Dependency and supply chain risk management* – a CTP must (as part of its obligation under Requirement 2) identify and manage any risks to its supply chain that could affect its ability to deliver a systemic third party service. See below for further information on this requirement.

- *Requirement 4: Technology and cyber resilience: Technology and cyber resilience* – a CTP must (as part of its obligation under Requirement 2) ensure the resilience of technology that delivers, maintains or supports a systemic third party service.

- *Requirement 5: Change management* – a CTP must ensure that it has a systematic and effective approach to dealing with changes to a systemic third party service, including changes to the processes or technologies used to deliver, maintain or support that systemic third party service. This includes by implementing appropriate policies, procedures and controls and ensuring that, before implementation, any proposed change is appropriately risk-assessed, recorded, tested, verified and approved.

- *Requirement 6: Mapping* – a CTP must – within 12 months of being designated by HM Treasury – identify and document (i.e. map):

    - The resources, including the persons, assets, supporting services and technology used to deliver, support and maintain each systemic third party service it provides; and

    - Any internal and external interconnections and interdependencies between those resources.

- *Requirement 7: Incident management* – a CTP must manage effectively "CTP operational incidents" – i.e. single events (or a series of linked events) that cause serious disruption to the delivery of a systemic third party service or impacts upon the CTPs operations such that the availability, authenticity, integrity or confidentiality of firms' assets which the CTP has access to as a result of providing a systemic third party service is or may be seriously and adversely impacted. See below for further information on this requirement.

- *Requirement 8: Termination of a systemic third party service* – a CTP must have in place appropriate measures to respond to a termination of any of its systemic third party services, for any reason.

The Supervisory Statement SS6/24 sets out a number of regulatory expectations in relation to meeting each of these requirements.

Requirement 3 in relation to supply chains

In relation to Requirement 3 (dependency and supply chain risk management) "supply chain" is defined as the network of persons that provide infrastructure, goods, services or other inputs directly or indirectly used by a CTP to deliver, support or maintain a systemic third party service.

As we had previously noted, the Regulators had proposed in the consultation that, not only should the CTP be required to identify and manage any risks to its supply chain that could affect its ability to deliver a material service but also that it should take "*all* reasonable steps" to ensure that *each person in its supply chain* understands the requirements that apply to the CTP, takes appropriate action to facilitate the CTP meeting those requirements and provides the regulators with access to any information relevant to them exercising their oversight functions.

In the final rules, and in a welcome move, the Regulators have ameliorated this additional, onerous requirement, by limiting it to the CTP's key "*key nth-party providers*" (i.e. persons who are part of the CTP's supply chain who are *essential* to the delivery of a systemic third party service) and to "*persons connected with a critical third party*" (i.e., members of the CTP's group, controllers of the CTP and (broadly) officers, managers, employees and agent of the CTP or a parent undertaking of the CTP). While the CTP will remain responsible, as before, for identifying and managing risks within its supply chain – and this should not be underestimated – it will at least be able to focus its efforts on meeting the additional burdensome requirements in relation to those providers in the supply chain that are essential to the delivery of the service (and on connected persons), rather than every link along what may be a very long supply chain.

Requirement 7 in relation to incident management – the playbook

The requirement to manage CTP operational incidents effectively includes the obligation to maintain and operate an "incident management playbook". In the consultation, the Regulators had proposed that this should be a bespoke, specially developed "*financial sector incident management playbook*". In the final rules, the requirement is to have an "incident management playbook" (more simply defined as any document that sets out at least the matters required by the relevant rule). This means that CTPs will be allowed to use their existing, documented incident management policies and procedures without having to develop a bespoke playbook, provided those policies and procedures adequately cover the requirements.

In addition to scenario testing, CTPs will need to assess the effectiveness of its incident management playbook regularly including by undertaking an appropriate "incident management playbook exercise" using a representative sample of the firms to which it provides services (essentially a simulation of an incident, based on severe but plausible scenarios, designed to test the effectiveness of the playbook). This exercise needs to be carried out within the first 12 months of being designated, and once every two years thereafter.

Self-assessment of compliance

In the consultation, there was a requirement that CTPs prepare and submit to the Regulators an annual written self-assessment of compliance with the rules, with the first version being supplied within three months of designation, and further versions being due each year. These requirements survive in the final rules, but have been clarified as a requirement to provide an *interim self-assessment* within 3 months of being designated (which is designed to enable the Regulators to get an early indication of whether a CTP is able to meet the rule requirements) followed by, annually thereafter, an *annual self-assessment*. The Regulators have common expectations for interim and annual self-assessments which are spelt out in the Supervisory Statement SS6/24:

among other things, the self-assessments should be clear and concise and must contain certain prescribed information. They should also be balanced, thorough and transparent, identifying areas for improvement and remediation and avoiding excessive "good news culture". Any information to which the self-assessment refers (such as audit reports, test results etc) must be available to the Regulators on request.

Incident reporting

CTPs will be required, as soon as is practicable after the occurrence of a CTP operational incident, to submit certain prescribed information to the Regulators and affected firms (insofar as it is aware of those things at the time of submission). In the final rules, the Regulators have "clarified and streamlined" the information that CTPs will be required to submit in their initial, intermediate and final incident reports (although the requirements still remain detailed). SS6/24 sets out further details as to the Regulators' expectations with regards to incident reporting and alludes to the fact that a voluntary reporting template will be available "in due course".

Section 166, discipline and enforcement

Each of the Regulators is empowered to require a CTP, or any person connected with it, to appoint a skilled person to product a report under section 166 FSMA 2000 or to collect or update information under section 166A FSMA 2000. A "skilled person" is a person that has the relevant expertise, knowledge and resources necessary to conduct the relevant review (or to collect or update information) It is often an accountancy firm (and sometimes a boutique accountancy firm that specifically specialises in conducting skilled persons reviews) The Regulators may themselves appoint the skilled person if need be (the FCA maintains a panel of firms for such purposes). The CTP will bear the cost of the skilled person's appointment, which means that the Regulators will be relieved from having to commit their enforcement resources at least at this initial stage. Each of the Regulators sets out in their rules their policies with regards to the use of skilled persons.

While the Regulators have the power of censure (under section 312Q FSMA 2000), the primary legislation does not empower them to issue financial penalties against a CTP they consider to be in breach of the requirements of the CTP regime. What they can do, however, is effectively stop the CTP from providing its services (and the authorised firm or FMI from receiving them) (Section 312R FSMA 2000).

Address for service in the UK

As discussed, while the threat to the stability of the UK financial regime is at the heart of the designation criteria, the CTP regime is "agnostic" about the location of the CTP itself: it will apply to a third party provider assessed as critical and designated as such wherever it is located in the world. There is no requirement in the regime for a CTP to subsidiarise or to establish a UK branch. In the consultation, to address the fact that a CTP's head office might be outside the UK, the Regulators had proposed that such an *offshore* entity would have to nominate a legal person (e.g. law firm) in the UK with authority to receive documents and notices from the Regulators.

In the final rules this has been simplified. All CTPs (wherever located and including those in the UK) must provide an address for service of documents (including statutory notices) in the UK. It should be noted that this is separate, and in addition, to the requirement to appoint one or more persons as the designated point of contact under Requirement 1 of the CTP Operational Risk and Resilience Requirements (see above).

Interoperability with non-UK regimes or duplication of effort?

There is much talk in this area (and others of course) about the desire, if not the need, to ensure interoperability of regulatory requirements. One of the points that respondents to the Regulators' consultation raised "most frequently and strongly" was the importance of the UK CTP oversight regime aligning to international standards and being interoperable with similar non-UK regimes – for instance, DORA in the EU and the Bank Service Company Act in the US.

As we have noted before, there is undoubtedly an overlap between the UK CTP regime and parts of the EU DORA regime but the requirements are not identical, particularly when you get down to granular incident management and reporting requirements and who those requirements apply to. For instance, the definition of CTP operational incident for the purposes of the CTP regime is not fully aligned to the definition of an ICT-related incident under DORA and the Regulators resisted the suggestion that they should be identical: for instance, the requirement to report an ICT-related incident under DORA applies to EEA financial entities, not those entities that will be designated CTPs under the UK regime; and the latter, for instance, will be under an obligation to report *all* CTP operational incidents, as defined, some of which will not amount to ICT-related incidents under DORA.

UK-regulated financial services providers will not be subject to the CTP regime per se: they will continue to be subject to the existing rules, guidance and regulatory expectations that relate to operational resilience and third party risk management.

OPERATIONAL INCIDENT AND THIRD PARTY REPORTING: REGULATORS' CONSULTATIONS

WHAT IS THIS? Parallel consultations from the FCA, the PRA and the Bank of England proposing (broadly) that all firms and FMIs should make notifications of certain operational incidents and certain firms should make notifications of material third party arrangements (over and above their obligations to notify material outsourcings).

WHO DOES THIS APPLY TO? The FCA requirement to notify "operational incidents" would apply to all firms and payment service providers (UK RIEs, registered trade repositories and registered credit rating agencies would also be caught). The requirement to notify "material third party arrangements" (and to maintain a register of such arrangements) would apply to a narrower section of firms – broadly, enhanced SMCR firms, CASS large firms, designated investment firms, banks, building societies and Solvency II firms. Authorised electronic money institutions and authorised payment institutions are also caught. The PRA requirements will apply to the regulated banking sector (UK banks, building societies, PRA-designated investment firms and branches of overseas banks) and insurers (UK Solvency II firms, the Society of Lloyd's and its managing agents. Separate Bank of England requirements will apply to financial market infrastructures.

WHEN DOES THIS APPLY? All consultations close on 13 March 2025. The regulators will consider feedback and plan to publish their final rules in H2 2025.

If the UK critical third parties regime (see above) were to be seen – in loose terms – as approximating one "half" of the ground covered by EU DORA (in terms of regulating third party technology providers), then the regulators'

December 2024 consultations, FCA CP24/28: Operational Incident and Third Party Reporting, PRA CP17/24 – Operational resilience: Operational incident and outsourcing and third-party reporting and Bank of England CP Operational resilience: operational incident and outsourcing and third-party reporting for financial market infrastructures might equally loosely be seen as plugging the other "half" (in terms of requiring regulated entities to notify their relevant regulator of operational incidents).

We summarise below the provisions of the FCA consultation. The FCA developed its proposals with the PRA and the Bank of England, and the regulators have endeavoured to ensure that their policy approaches are consistent with one another. Accordingly, the proposals that apply to PRA-regulated firms and FMIs are similar in substance to those proposed under the FCA consultation – because of that similarity, they are not specifically considered below.

The FCA consultation

In outline, the FCA proposes that:

- All firms and payment service providers (and certain others) will be required to report "operational incidents" to the FCA, following prescribed procedures and using template forms.

- A smaller subset of larger firms – enhanced SMCR firms, CASS large firms, designated investment firms, authorised electronic money institutions, authorised payment institutions, banks, building societies and Solvency II firms – will be required to:

    - report "third party arrangements" (over and above the existing obligation to report material outsourcings), again following prescribed procedures and using a dedicated template form); and

    - maintain a register of such third party arrangements.

The Consultation closes on **13 March 2025**, and the FCA expects to publish its policy statement and final rules in H2 2025.

Operational incident reporting

Who is in scope?

All firms, payment service providers, UK RIEs, registered trade repositories and registered credit rating agencies will be subject to these new rules.

Definition of operational incident

An "operational incident" will be newly-defined as meaning either a single event or a series of linked events which disrupts a firm's operations such that it disrupts the delivery of a service to the firm's clients or a user external to the firm or impacts the availability, authenticity, integrity or confidentiality of information or data relating or belonging to the firm's client or such external user.

Thresholds – a judgment call for firms

Not all operational incidents, as defined, will be reportable. Whether an incident is reportable will depend on whether one or more of three thresholds is breached:

- the operational incident could cause or has caused intolerable levels of harm to consumers from which consumers cannot easily recover;
- the operational incident could pose or has posed a risk to market stability, market integrity or confidence in the UK financial system; or
- could pose or has posed a risk to the safety and soundness of the firm and/or other market participants.

The thresholds are not as objective as they might first appear. As the FCA says in its narrative (although not in the draft rules themselves) it will be for individual firms themselves to judge which incidents breach the thresholds – one firm may validly conclude that the actual or potential impact of an operational incident does not cross any of the thresholds, while others may – equally correctly – decide that the same or similar incident crosses one or more of the thresholds from their perspective and is therefore reportable. It will depend on many factors, including the nature and size of the firm and its client base. Furthermore, it will be seen that the firm must address its subjective assessment not only to operational incidents that have actually given rise to the relevant harms or risks, but also those which have the *potential* to cause those harms or risks. This will add another layer of speculation to the assessment.

The consultation narrative sets out a number of non-exhaustive factors that firms should consider in making their assessments, together with a number of (fairly axiomatic) case studies.

Template notifications

Having identified a notifiable operational incident, a firm must follow a set procedure. It must submit to the FCA, so far as it is aware, an **initial report** in a template format as soon as practicable after the occurrence of the operational incident. The incident reporting data tables in the prescribed template have been aligned – "where possible" – with other incident reporting regimes and international standards. The FCA makes specific reference to FSB's development of a common Format for Incident Reporting Exchange (**FIRE**) and the recommendations in the FSB FIRE consultation report (October 2024, consultation closed 19 December 2024). The FCA also makes reference to EU DORA, although, given the granularity of the respective requirements, it remains to be seen how truly interoperable incident reporting under the UK and EU regimes will be for firms.

Firms will be required to submit an **intermediate report** in a template format as soon as practicable after any significant change in circumstances from those described in the initial report – this includes resolution of the incident but other examples are given (e.g. additional information providing more context on the incident, the impact of the incident changes, the deployment of a business continuity plan).

After confirming the resolution of an operational incident (in an intermediate report as above), firms will be required to submit a **final report** in a template format within 30 working days of the resolution of the incident or, where this is impracticable "as soon as practicable, but not exceeding 60 working days".

The draft templates for all three forms are available in the xlsx document linked to in Annex 2 of the consultation document.

Relationship with PSD2 notifications

As noted above, payment service providers will be caught by the new rules. However, they will continue to be required to make notifications under regulation 99(1) of the Payment Services Regulations 2017 (SUP 15.14.20D and SUP 15.14.21D). However, in circumstances where a PSD2 notification relates to an operational incident which the firm deems to have breached one or more of the above thresholds, the PSP will have to make an *additional* notification under the new rules despite having made a PSD2 notification.

Notification of material third party arrangements

Who is in scope?

In addition to the operational incident notification requirements above, FCA proposes to expand the scope of the existing material outsourcing notification requirements. This expansion will apply (as the existing requirements apply) to enhanced SMCR firms, CASS large firms, designated investment firms, authorised electronic money institutions (**EMIs**), authorised payment institutions (**APIs**), banks, building societies, Solvency II firms – as well as to UK RIEs and a consolidated tape provider.

Definitions of " third party arrangements" and "material third party arrangements"

A "third party arrangement" will be newly-defined as meaning an arrangement of any form between a firm and a service provider, whether or not the product or service is one which would otherwise be provided by the firm itself or provided directly or by a sub-contractor or provided by a person within the same group as the firm. The significance of this definition is that it catches all such third party arrangements, whether or not they are outsourcings.

A "material third party arrangement" is a third party arrangement (as defined above) which is of such importance that a disruption or failure in the performance of the product or service provided to the firm could:

- cause intolerable levels of harm to the firm's clients;
- pose a risk to the soundness, stability, resilience, confidence or integrity of the UK financial system; or
- cast serious doubt on the firm's ability to satisfy the threshold conditions, or meet its obligations under the Principles or under SYSC 15A (operational resilience).

It will be seen that these qualifiers are not dissimilar (although by no means identical) to the thresholds for determining whether an operational incident is reportable. The draft rules set out a number of factors which firms should take into account in determining whether a third party arrangement is material, and therefore notifiable.

If the firm is an in-scope manager of an AIF or UK UCITS (e.g. because it is an enhanced scope SMCR firm) then the meaning of "client" above (when determining whether the disruption or failure could cause intolerable levels of harm to clients) is extended to investors in the AIF and unitholders in the UK UCITS.

The notification requirement

An in-scope firm must give the FCA notice when entering into, or significantly changing, a material third party arrangement. Statutory audits and basic utilities, such as electricity, gas and water (which may be material third party arrangements by definition) are expressly excluded from the notification requirement, although telecommunication and internet service providers are not – clearly a disruption or failure in the latter may well constitute a notifiable material third party arrangement.

The consultation paper indicates that the notification must be made on the template set out in the xlsx document linked to in Annex 3 of the consultation document (although that links to the template described as the *register* of material third party arrangements – it is not clear whether the intention is that the same document will serve for both purposes).

Register of material third party arrangements

Who is in scope?

The same firms that are subject to the notification requirements in relation to material third party arrangements.

The requirement to maintain and submit a register

An in-scope firm must maintain a register of information relating to its material third party arrangements and submit that register to the FCA on an annual basis. As above, statutory audits and basic utilities are expressly excluded.

The firm must use the template set out in the xlsx document linked to in Annex 3 of the consultation document and must submit it through the "appropriate systems" on the FCA website.

9 MARKETS AND TRADING

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
17 February 2025	PISCES	FCA consultation closes
Early 2025	PISCES	FCA will publish further information about pre-application engagement opportunities for would-be operators
By May 2025	PISCES	HM Treasury intends to lay PISCES legislation

ITEMS COVERED IN THIS SECTION

EU SECURITISATION REGIME: EUROPEAN COMMISSION CONSULTATION ON THE FRAMEWORK

WHAT IS THIS? A European Commission targeted consultation on the functioning of the EU Securitisation Framework

WHO DOES THIS APPLY TO? The consultation was relevant to: issuers, investors, sponsors, servicers, arrangers, third-party verifiers, data repositories, rating agencies, IORPs and other pension funds, industry associations and research institutions.

WHEN DOES THIS APPLY? The consultation closed on 4 December 2024. The responses will feed into the review of the securitisation framework to be considered by the Commission "in the next mandate". If considered appropriate, a formal Commission proposal for changes to the framework would follow, but clearly this will not be for some time.

On 4 October 2024, the European Commission issued a targeted consultation on the functioning of the EU securitisation framework. The consultation closed on 4 December 2024. The Commission will consider the feedback when preparing – if considered appropriate – a formal Commission proposal.

The consultation sought views on a wide variety of issues, including:

- The effectiveness of the securitisation framework overall – and its impact on the market and the policy goals of the capital markets union.
- The impact of the securitisation framework on SME financing.
- The scope of application of the Securitisation Regulation – this included questions on jurisdictional scope, the definitions of a "securitisation" and "sponsor".
- Due diligence requirements.
- Transparency requirements and definition of public securitisation.
- Supervision.
- The STS standard and STS criteria.
- Third-party Verifiers (TPVs).
- The possibility of setting up a pan-EU securitisation platform.
- Prudential and liquidity treatment of securitisation for banks (including specific questions relating to the relevant risk weight floors, the (p) factor, the concept of significant risk transfer (SRT) and liquidity risk treatment in the LCR Delegated Regulation.
- Prudential treatment of securitisation for insurers
- Prudential framework for IORPs and other non-IORP pension funds.

UK SECURITISATION REGIME: AN UPDATE

WHAT IS THIS? The new UK securitisation regime – constituted by the Securitisation Regulations 2024 (as amended) and the firm-facing requirements set out in the FCA Handbook and the PRA Rulebook. This replaced the onshored UK Securitisation Regulation.

WHO DOES THIS APPLY TO? Originators, original lenders, sponsors, SSPEs and institutional investors. Also relevant to securitisation repositories (and bodies corporate applying to be registered as securitisation repositories), trade repositories, sellers of securitisation positions, persons applying to be registered as third party verifiers and retail clients.

WHEN DOES THIS APPLY? 1 November 2024

On 2 September 2024, The Financial Services and Markets Act 2023 (Commencement No.7) Regulations 2024 were made. They revoked, on 1 November 2024, certain instruments listed in FSMA 2023 relating to securitisation:

- The Securitisation Regulations 2018.
- The provisions of the retained EU Securitisation Regulations 2017 that had not already been revoked.
- A number of regulatory technical standards and implementing technical standards that amended or supplemented the EU Securitisation Regulation 2017 and the EU Capital Requirements Regulation.

The revocation enabled the new UK regime to come into force – the following therefore took place on **1 November 2024**:

- The main commencement day for The Securitisation Regulations 2024 (an Explanatory Memorandum is available).
- The date on which the new FCA firm-facing securitisation rules came into force – SECN Securitisation Sourcebook.
- The date on which the new PRA firm-facing securitisation rules came into force:
    - The Securitisation Part of the PRA Rulebook.
    - An updated PRA Supervisory Statement SS10/18 – Securitisation: General requirements and capital framework.

The new UK regime replaced the onshored UK Securitisation Regulation (which was derived from the EU Securitisation Regulation) and is now fully in force.

On 21 November 2024, The Securitisation (Amendment)(No.2) Regulations 2024 were made and came into force on 22 November 2024. Under regulation 12 of the Securitisation Regulations 2024, there is a temporary grandfathering provision that allows originators, sponsors or SSPEs to use the designation "STS" or simple, transparent and standardised" where the securitisation is a "qualifying EU securitisation". Broadly, as originally drafted, this temporary provision related to EU securitisations notified to ESMA up to and including 31 December 2024. The effect of minor amendment under the Amendment (No.2) Regulations is to extend that date to **30 June 2026**, so extending the temporary arrangement by another 18 months.

PISCES: A BRIGHT NEW CONSTELLATION ON THE PRIVATE SECONDARY MARKET?

WHAT IS THIS? A new exchange for the trading of private securities on the secondary market.

WHO DOES THIS APPLY TO? Only private companies and PLCs whose shares are not admitted to trading on public markets in the UK or abroad can be traded on PISCES. Investors eligible to trade on PISCES will be limited, but include institutional investors, "professional clients", employees of a company participating on PISCES and high-net worth individuals and certified and self-certified sophisticated investors. Only UK RIEs and firms with permission to arrange deals in investments, operate an MTF or operate an OTF will be eligible to apply to become a PISCES operator.

WHEN DOES THIS APPLY? The Treasury intends to introduce PISCES legislation by May 2025. The FCA has published a consultation on its proposed rules for PISCES which closes on 17 February 2025. When the government has laid the statutory instrument before Parliament, the FCA will finalise its rules after which formal applications for PISCES operators will open. The FCA will publish further information "in early 2025" about "pre-application engagement opportunities" for would-be operators. No "go live" date is currently specified.

HM Treasury published a consultation paper in March 2024 setting out its proposals for a new Private Intermittent Securities and Capital Exchange (**PISCES**). On 14 November 2024, and in light of the feedback to the proposals, the Treasury published the Government response alongside draft legislation, The Financial Services and Markets Act 2023 (Private Intermittent Securities and Capital Exchange System Sandbox) Regulations 2025 and an associated policy note. Technical comments on the draft legislation were invited by 9 January 2025. It is expected that the final statutory instrument will be laid before Parliament by May 2025.

On 17 December 2024, the FCA published CP24/29: Private Intermittent Securities and Capital Exchange System: Sandbox Arrangements setting out the regulator's proposed rules and guidance for the PISCES sandbox. Consultation closes on **17 February 2025**.

The concept of PISCES – an intermittent trading venue for private shares – was first announced in December 2022 as part of the Edinburgh Reforms.

It remains to be seen how much traction this gets (and whether a new regime flourishes after the 5 year sandbox) and whether this will present an attractive opportunity for the private equity industry.

The government response and draft Regulations

In the light of the Government response and the draft Regulations, the key features of the regulatory framework for PISCES are as follows:

- *Sandbox*: It will be developed using the existing FSMA 2023 powers as an FMI sandbox.
    - The sandbox will test regulatory requirements for PISCES over 5 years – after that non-sandbox legislation would be required to regulate PISCES going forward.
    - This will enable the government/FCA to temporarily modify or disapply various provisions within FSMA 2000, the Companies Act 2006 and MiFID and market abuse legislation.
    - Firms wishing to operate a PISCES platform will have to apply to the FCA and once approved will be able to run intermittent trading events for participating companies.
- *Operators of a multilateral system:* PISCES will be a multilateral trading system for the intermittent trading of shares operated by a firm that is:

- A person established in the UK with Part 4A permission to “arrange deals in investments” (Article 25(1) Regulated Activities Order), “operate an MTF” (article 25D Regulated Activities Order) or “operate an OTF” (Article 25DA Regulated Activities Order). It should be noted that, while permission to operate an MTF or OTF are eligibility criteria, and PISCES will be a multilateral system for the purposes of this regime, UK MiFIR will be amended to exclude PISCES from the definition of "multilateral trading facility" or "MTF". The MiFID Org Regulation will also be amended to make clear that if any Article 3 MiFID exempt firm becomes a PISCES operator, it will be treated – for the specific purposes of the PISCES regime – as if it were a MiFID firm.
- A Recognised Investment Exchange (RIE) (that is not an overseas investment exchange).

- *Secondary market*: It will operate only as a secondary market for existing shares – it will not facilitate capital raising through the issuance of new shares, or the trading of any other securities (such as bonds, ETFs etc).
- *Eligible companies*:
    - Only shares in companies whose shares are not admitted to trading on public markets in the UK or abroad can be traded on PISCES. This will include UK private and public limited companies (defined by the Companies Act) and overseas companies. It will be left to PISCES operators to determine any admission requirements (e.g. minimum or maximum size caps, minimum corporate governance requirements). These will not be set by the legislation.
    - Share buybacks will not be permitted at the initial launch stage.
- *Eligible investors*: Only the following will be able to participate in the FMI sandbox arrangements of PISCES *as investors* (the draft Regulations set out more details as to who may purchase on the investors' behalf, including bare trustees, nominees or custodians and through whom they may trade (i.e. through FCA authorised firms, members or participants of PISCES and appointed representatives):
    - Employees of those companies participating on PISCES.
    - A relevant trustee of an employee share scheme of a company participating on PISCES.
    - A trustee of a share incentive plan for (broadly) employees, directors and officers of a company participating on PISCES.
    - High-net worth individuals (as defined by Article 48(2) FPO).
    - High-net worth companies or unincorporated associations or trustees of high-value trustees (as defined by Article 49(2) FPO) – so pension funds and private equity investors will be eligible investors.
    - Self-certified sophisticated investors (as defined by Article 50A FPO).
    - Certified sophisticated investors (as defined by Article 50 FPO).
    - "Professional clients" (as defined by UK MiFIR Annex 1).

- *Intermittent*: it will operate intermittent trading windows (e.g. monthly, quarterly, biannually etc) "intermittent" is defined in the draft legislation as meaning "occasional, not frequent, and of limited duration.

- *Transparency disclosures*: the government envisages modified disclosures and pre- and post-trade transparency requirements. Disclosure requirements specific to PISCES will only apply shortly before and after each trading window, and will only be made available to investors to enable them to trade during the window. There will be no requirement for information to be disclosed to the public. The FCA will consult on detailed disclosure rules.

- *Market abuse*: contrary to what was proposed in the consultation, the PISCES regime will not include a public "market style" market abuse regime. Instead, and in keeping with the "hybrid" nature of a market that will operate in a space somewhere between existing private and public markets, the FCA will be given rule-making powers to create a new and bespoke disclosure regime for PISCES, under which disclosures and pre- and post-trade transparency must be shared with all investors participating in a PISCES trading event.

- *Transaction reporting:* because there will not be a market abuse regime, the government has dropped the idea of having a transaction reporting regime. The FCA will separately consider (and, if relevant, consult on) record-keeping rules.

- *Financial promotions*: the existing financial promotion regime will apply and there will be a new FPO exemption relating to mandatory PISCES disclosures (this will be based on the corresponding FPO exemptions for mandatory public market disclosures and will provide that any disclosures that are required or permitted by the FCA or the rules of a relevant PISCES operator will be exempt). The FPO will be amended to provide that shares on PISCES are considered "shares in an unlisted company": this means that, where relevant, the exemptions for high-net worth individuals and self-certified sophisticated investors will be available. As the FCA consultation (see below) points out, any promotions which are not exempt from the financial promotion restriction and which are communicated, or caused to be communicated, by an unauthorised person (such as the PISCES company itself) will need to be approved by an authorised person that is lawfully able to provide that approval – either on the basis of permission (i.e. because it has passed through the Financial Promotion Gateway and is able to approve financial promotions) or within the scope of a relevant exemption from the requirement to be so permitted.

- *Settlement arrangements*: PISCES operators will have the discretion to decide whether or not shares must be recorded on a central securities depository (CSD).

The FCA consultation

The FCA consultation addresses a number of rule requirements that would be imposed on PISCES operators relating to: disclosure arrangements, organising and running intermittent trading events and market manipulation and oversight. The consultation also has a chapter on the FCA's approach to operating the PISCES sandbox, and application requirements.

There are also some specific requirements that will attach to trading intermediaries (authorised firms, appointed representatives and members and participants with access to PISCES) when they promote and distribute PISCES shares. The proposed rules, similar to those that currently apply to non-readily realisable securities, will place limitations on the way that intermediaries interface with eligible retail investors.

NEW UK SHORT SELLING REGIME

WHAT IS THIS? Publication of the draft framework for the new UK Short Selling Regime including powers for the FCA to develop detailed implementing rules.

WHO DOES THIS APPLY TO? All market participants.

WHEN DOES THIS APPLY? Not yet known.

In November 2024, HM Treasury published the draft Short Selling Regulations 2024 setting out the framework for the new UK Short Selling Regime. Additional, detailed implementing rules will be developed by the FCA.

The new UK short selling regime is effectively a revised version of the existing, EU-derived short selling regime tailored for the UK markets. We discussed the origins of the regime in our 2024 New Year briefing.

Under the new regime, certain activities related to short selling will be a "designated activity" as introduced by the Financial Services and Markets Act 2023. The FCA has wide powers to make rules in relation to designated activities with those rules applying not just to FCA-authorised firms but also non-regulated persons.

The Short Selling Regulations 2024 set out the scope of the new regime as well as the rule-making powers and obligations of the FCA.

As regards scope, the regime will apply where:

- a person enters into a short sale of an admitted share (i.e. a share admitted to trading on a UK trading venue including when traded outside that trading venue); or

- a person enters into any other transaction which has the effect of conferring a financial advantage in the event of a decrease in the price or value of an admitted share.

The Short Selling Regulations 2024 clarify that where there is a combination of legal and beneficial interests in a financial instrument, the instrument is considered to be owned by the beneficial owner who assumes the economic risk of acquiring it, including where the instrument is held by a nominee.

The FCA will have the power to make rules including:

- Rules requiring persons entering into a short sale of an admitted share to make arrangements to ensure or create a reasonable expectation that settlement of those transactions can be effected when due (such as entering into an arrangement to borrow the admitted share) and about the features of such arrangements.

- Rules requiring persons with a net short position of 0.2% or more in the issued shares of a company with admitted shares to notify the FCA of that position. The FCA has the power to make rules on how that position is to be calculated. The FCA must also publish the aggregate net short position of relevant companies based on the information received - this replaces the obligation to publish individual positions over 0.5%.

- Rules requiring additional notifications (including on net short positions at thresholds other than 0.2%) to be made in exceptional circumstances. Also rules to prohibit or impose conditions on short sales or similar transactions in exceptional circumstances or where there is a significant fall in price of a financial instrument.

- Exemptions for certain admitted shares or permitting modification of the rules in certain circumstances which could include certain market making or stabilisation activities.

The Short Selling Regulations 2024 also include obligations on central counterparties regarding buy-in which largely reflect those in the EU-derived Short Selling Regulations.

The FCA has not yet published its draft rules and therefore no date has been set as yet for the new UK short selling regime to come fully into force.

In the meantime, having conducted its biannual review (Article 16 of the UK Short Selling Regulation), the FCA published an updated UK List of Exempted Shares. The updated list applies from 1 January 2025.

10 MARKET ABUSE, MONEY LAUNDERING AND FINANCIAL CRIME

AT A GLANCE: DATES FOR THE DIARY

Note: this is an indicative table of key dates (actual, expected and possible) during 2025 and beyond. See sections below for further details.

Date	Topic	Matter
4 December 2024	EU Listing Regulation amendments to EU MAR	Date on which changes to the following provisions applied: Article 5: exemption for buy-back programmes and stabilisation; article 7: inside information; Article 11: market soundings; Article 18: insider lists; Article 19: managers' transactions
1 September 2025	Economic Crime and Transparency Act 2023	Failure to prevent fraud offence comes into force
1 January 2026	US AML Regime	New US AML/CFT rules for investment advisers start to apply
5 June 2026	EU Listing Regulation amendments to EU MAR	Date on which changes to the Article 17: public disclosure of inside information will apply
10 July 2027	EU AML regime	Firm facing requirements of new EU AML regime largely start to apply

ITEMS COVERED IN THIS SECTION

EU AML/CFT REGIME

WHAT IS THIS? New EU legislative measures in respect of anti-money laundering and countering the financing of terrorism including a new directly effective Anti-Money Laundering Regulation and a new EU central authority.

WHO DOES THIS APPLY TO? Entities subject to the EU anti-money laundering requirements which includes EU financial entities.

WHEN DOES THIS APPLY? Largely from 10 July 2027.

The legislation setting out the EU's revised anti-money laundering regime was finalised in June 2024 and will largely start to apply from 10 July 2027.

The main piece of legislation for financial services firms will be Regulation (EU) 2024/1624 (**AML Regulation**) which sets out the high-level obligations applicable to "obliged entities". These will, in many respects, be familiar from the current EU money laundering regime but there are a number of enhanced requirements as well as some new rules.

Key changes include enhanced customer due diligence measures, additional obliged entities including crypto-asset service providers and central securities depositaries and minor amendments to the rules on beneficial ownership. Additional requirements regarding sanctions have also been included. Further detail is expected in supplementary standards and guidance to be developed by the new EU Authority for Anti-Money Laundering and Countering the Financing of Terrorism.

We discussed these requirements and other key changes in our briefing: New EU anti-money laundering rules | Travers Smith.

Firms which are subject to the new regime will need to consider their existing policies and practices and make any necessary changes. For the most part, firms will not need to dramatically overhaul their existing practices but they will need to consider the new requirements carefully to see where there are gaps and where their current arrangements do not fully reflect their new obligations.

There will be extensive secondary legislation and guidance, but none of this is due until 2026.

EU LISTING ACT: AMENDMENTS TO EU MAR

WHAT IS THIS? Part of the EU Listing Act package which effected amendments to EU MAR.

WHO DOES THIS APPLY TO? All persons subject to EU MAR; firms conducting and receiving market soundings, EU issuers and their PDMRs

WHEN DOES THIS APPLY? 4 December 2024 (with some exceptions).

On 14 November 2024, the EU Listing Act package was published in the Official Journal. This package included:

- Regulation (EU) 2024/2809 of 23 October 2024 amending EU Prospectus Regulation (EU) 2017/1129 (EU Prospectus Regulation), the **EU Market Abuse Regulation** (EU) 596/2014 (**EU MAR**) and Regulation (EU) 600/2014 (EU MiFIR) (**EU Listing Regulation**).

The changes effected by the EU Listing Regulation to EU MAR are summarised below. All the changes appear to have applied with effect from **4 December 2024**, unless otherwise indicated below.

- *Art 5: exemption for buy-back programmes and stabilisation* – issuers will have to report every buy-back trade to the competent authority of the most relevant market in terms of liquidity (not to each competent authority of a trading venue on which the instruments are traded/admitted), but only publish aggregated information about the trades (as opposed to each individual trade)
- *Art 7: inside information* – a replacement of that part of the definition of inside information that relates to pending client orders (Art 7(1)(d)) – the previous wording limits this limb to "persons charged with the execution of orders" whereas going forward it will apply more expansively to "information conveyed by a client or by other persons acting on the client's behalf or information known by virtue of management of a proprietary account or of a managed fund".
- *Art 11: market soundings* – changes as follows:
  - A very minor change to the introductory wording (i.e. essentially the definition of a market sounding) just to clarify that a transaction does not necessarily need to take place for a market sounding to be made: "A market sounding comprises the communication of information prior to the announcement of a transaction**, if any,** in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as it potential size or pricing, to one or for potential investors by (etc)".
  - Changes to Article 11(4) to make it clear that disclosing market participant (**DMP**) is deemed to have disclosed inside information in the course of a market sounding in the normal exercise of their employment etc. provided it has complied with certain conditions – these are the conditions that are currently set out in Article 11(5)(which is deleted). In other words, the conditions in Article 11(5) are now wrapped into Article 11(4). This does not involve a change of substance but does perhaps make things clearer.
  - Changes to Article 11(6) and (7) – ordinarily, a DMP is required to notify the recipient of a market sounding as soon as possible as and when the DMP assesses that the market sounding ceases to be inside information. The amendment makes it clear that the DMP is relieved from this notification obligation in the event that the information has otherwise been announced publicly. The requirement for the person receiving the market sounding to assess for themselves whether they are in possession of inside information remains, but the obligation for them to assess when they *cease* to be in possession of inside information has been removed.
- *Article 17: public disclosure of inside information* – N.B. all of the following changes will apply as from **5 June 2026**:
  - A clarification to Art 17(1) to qualify the issuer's obligation to inform the public as soon as possible of inside information which directly concerns the issuer – this provides that that requirement won't apply to inside information related to intermediate steps in a protracted process as referred to in Article 7(2) and 7(3) where those steps are connected with bringing about or resulting in particular circumstances or a particular event – i.e. in a protracted process

while an intermediate step is capable of being inside information for the purposes of EU MAR generally, only the final circumstances or final event shall be required to be *disclosed* as soon as possible after reaching that point. Note that, this does not relieve an issuer of the fundamental disclosure obligation *per se* and does not change the potential categorisation of information about intermediate steps as inside information; it just affects the disclosure obligation.

  - A new Art 17(1)(a) will be inserted requiring the issuer to ensure the confidentiality of information meeting the definition of inside information until such time as it is disclosed.
  - Amendments to Art 17(4) to change one of the conditions for delay of disclosure – one of the current conditions is that the delay must not be likely to mislead the public. Going forward, the condition is reformulated so that the inside information which the issuer intends to delay is not in contrast with the latest public announcement or other type of communication by the issuer on the same matter to which the inside information relates. Note that non-disclosure by an issuer of inside information related to intermediate steps in protracted process is not subject to those conditions and is permissible in keeping with the changes to Article 17(1).
- *Article 18: insider lists*:
  - Art 18(6) essentially allows an issuer on an SME growth market to only include persons who have regular access to inside information on their insider lists. An amendment to Art 18(6) to specify that, by derogation, and where justified by market integrity concerns, Member States may require issuers on SME growth markets to include in their insider lists all the people referred to in 18(1) – i.e. the same as for non-SME growth market issuers.
  - Art 18(9) (which currently requires ESMA to develop the precise format for insider lists) is replaced by a new requirement for ESMA to review the implementing technical standards on the alleviated format of the insider lists for issuers admitted to trading on SME growth markets (as above) [with a view] to extending the use of such format to all insider lists.
- *Article 19: Managers' transactions*: there are some changes to the PDMR responsibilities
- *Articles 23 – 35*: various relatively minor changes (powers of competent authorities, obligation of NCAs to cooperate with one another, a new mechanism to exchange order data (art 25a), new collaboration platforms (art 25b), the deletion of art 28 data protection), amendment to the disclosure of personal data to third countries, amendments to administrative sanctions, exercise of supervisory powers and imposition of sanctions.

Amendments to EU MAR – ESMA consultation on technical advice

On 12 December 2024, ESMA published a consultation paper that included draft technical advice to the European Commission in relation to the implementation of the changes to EU MAR effected by the Listing Act. Consultation closes on **13 February 2025**.

The consultation sets out ESMA's technical advice on the disclosure of inside information in a protracted process (see the amendments to Article 17(1) EU MAR above), the delayed disclosure of inside information (see the amendments to Article 17(4) above) and the new mechanism to exchange order data (see new Article 25a above). A draft Regulation setting out ESMA's proposed text is attached.

WHAT IS THIS? A round-up of UK money laundering developments.

WHO DOES THIS APPLY TO? For the most part, persons subject to the obligations in the Money Laundering Regulations 2017 which includes financial services firms.

WHEN DOES THIS APPLY? Various.

HM Treasury consultation on the Money Laundering Regulations

HM Treasury issued, in early 2024, a consultation on potential amendments to the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**MLRs**): HM Treasury Consultation on Improving the Effectiveness of the Money Laundering Regulations.

The proposed amendments were relatively targeted and there was no suggestion that HM Treasury was planning more fundamental changes to the MLRs or the UK anti-money laundering regime. Travers Smith contributed to a letter from the Financial Markets Law Committee which suggested some broader changes which could be made.

The consultation considered measures to make customer due diligence more proportionate and effective including questions on:

- Whether the triggers for customer due diligence are sufficiently clear and whether further clarity on the establishment of a "business relationship" would be helpful.

- Whether clarity can be provided on when to carry out "source of funds" checks including possible sector specific guidance.

- Whether the requirement to verify anyone "acting on behalf of" a customer is clear enough particularly where the customer or person is a corporate entity. HM Treasury thinks that firms may be treating a wider range of scenarios as falling under the requirements than is necessary.

- How best to support the use of digital identity when verifying customer identity with the possibility of bespoke guidance.

- The appropriateness of certain risk factors that have to be taken into account under the MLRs for enhanced due diligence and the requirement to apply enhanced due diligence to "complex or unusually large" transactions.

- Whether there should be additional low risk factors for simplified due diligence.

The consultation also considered whether there could be further clarity on the scope of the MLRs including questions on:

- How the thresholds in the MLRs which are currently listed in euros could be changed to pound sterling (but no significant changes to the value of the thresholds are proposed).

- Potential gaps in the regulation of Trust Company and Service Providers with possible extension to the sale of “off the shelf” companies.

Other topics considered included strengthening coordination between supervisory authorities and reforming registration requirements for the Trust Registration Service.

The consultation closed on 9 June 2024 and, as at the date of this Briefing, HM Treasury has not published its response.

FCA guidance on the Treatment of PEPs

The FCA published, in July 2024, the results of its multi-firm review on how firms treat politically exposed persons (**PEPs**) when carrying out anti-money laundering checks.

This included the FCA's findings on how effectively firms were following the FCA's guidance in FG17/6: The treatment of politically exposed persons for anti-money laundering purposes which the FCA expected all firms to consider and to make any necessary changes.

In addition, the FCA proposed amendments to the guidance in FG17/6: GC24/4: Proposed amendments to FG17/6 - Guidance on the treatment of politically exposed persons (PEPs). This was largely to reflect recent legislative changes regarding the treatment of UK PEPs as lower risk. The consultation on these changes closed on 18 October 2024 and, at the time of publication, no finalised guidance has been issued.

We discussed the FCA's findings and the proposed changes in more detail at the time in our briefing: **FCA Provides Further Guidance on the Treatment of PEPs**.

FAILURE TO PREVENT FRAUD OFFENCE

WHAT IS THIS? An offence making certain large organisations and their subsidiaries criminally liable for fraud offences committed by their employees and certain other associated persons.

WHO DOES THIS APPLY TO? Large organisations and their subsidiaries.

WHEN DOES THIS APPLY? 1 September 2025.

The Economic Crime and Corporate Transparency Act 2023 came into force at the end of 2023 and we discussed this in more detail in our 2024 New Year Briefing: Financial Services Regulation 2024 - New Year briefing | Travers Smith

This is a wide-ranging piece of legislation which included a number of new requirements for corporate entities and for registered limited partnerships as well as changes to money laundering legislation, the attribution of criminal liability to bodies corporate or partnerships and a new failure to prevent fraud offence.

Following the publication in November 2024 by the government of its guidance to organisations on the offence of failure to prevent fraud, the failure to prevent fraud offence will come into effect on **1 September 2025**.

Broadly, under the failure to prevent fraud offence, "large organisations" would be guilty of an offence if a fraud offence is committed by an "associate" (which includes an employee, agent, subsidiary or person providing services on its behalf) and the offence is committed for the benefit of the organisation or a person to whom it provides services. Large organisations are defined as those satisfying two or more of the following: turnover over £36 million; balance sheet of more than £18 million; and/or over 250 employees. Where the relevant entity is a parent undertaking, this may also take into account its subsidiaries.

In addition, the subsidiary of a large organisation can also be held liable if it fails to prevent fraud committed by its employee where the fraud is intended to benefit the subsidiary.

Fraud offences for these purposes includes various economic crime offences such as false accounting and false statements.

In either case, there is a potential defence where the relevant entity had reasonable fraud prevention procedures in place. The government's guidance includes detailed advice on the procedures that relevant entities can put into place to evidence this.

For many firms, getting their scoping assessments right will be the first step – and one of crucial importance.

Further details on the offence and the guidance can be found in the following briefing: **Failure to prevent fraud guidance published – what do businesses need to do now? | Travers Smith**

NEW US AML/CFT RULES FOR INVESTMENT ADVISERS

WHAT IS THIS? Extension of US AML/CFT requirements.

WHO DOES THIS APPLY TO? Certain financial services entities, including certain US and non-US investment advisers.

WHEN DOES THIS APPLY? 1 January 2026.

New rules extending AML/CFT requirements to additional financial services entities, including certain US and non-US investment advisers, have been introduced in the US (**AML/CFT Rules**).

The AML/CFT Rules will apply to Registered Investment Advisers (**RIAs**) and Exempt Reporting Advisers (**ERAs**) other than mid-size advisers, multi-state advisers, pension consultants and RIAs that do not report any AUM. State-registered advisers, foreign private advisers and family offices are not expected to be caught by the AML/CFT Rules.

As regards foreign entities, foreign-located investment advisers which have their principal office and place of business outside the US are expected only to be caught in respect of their advisory activities which:

- take place within the US including through the involvement of US personnel of the investment adviser (such as the involvement of a branch, agency or office in the US); or

- are provided to a US person or a foreign private fund with at least one US investor (according to the Financial Crimes Enforcement Network (**FinCEN**), a bureau of the US Department of the Treasury, some element of "look-through" will apply).

According to FinCEN, foreign-located investment advisers will be caught by the AML/CFT Rules if they are RIAs or ERAs. FinCEN expects that most non-US entities will be "foreign private advisers" which fall outside the scope of SEC registration or filing requirements.

For the purposes of assessing whether a foreign-located investment adviser has properly scoped out which of its activities are subject to the AML/CFT Rules, a foreign-located investment adviser will have to make its records and reports under the AML/CFT Rules and any records regarding the scope of its activities available for inspection by FinCEN and/or the SEC. There is no specific exemption in the AML/CFT Rules for foreign advisers who comply with other equivalent regimes.

Key obligations for in-scope entities will include:

- A written AML/CFT Program with policies and controls reasonably designed to prevent the entity from being used for money laundering, terrorist financing and other illicit finance activities, customer due diligence procedures including ongoing monitoring and independent testing for compliance. The AML/CFT Program will need to be made available for inspection by FinCEN and/or the SEC. According to FinCEN, it will not be necessary to apply the AML/CFT Program to non-advisory services which may include certain activities undertaken in connection with private funds' portfolio companies (such as making managerial/operational decisions about their activities).

- A requirement to report suspicious transactions. However, according to FinCEN, in the case of portfolio companies, it will not be necessary to collect additional information from portfolio companies about their activities and in-scope entities should be able to satisfy this requirement through the information available to them in the course of directing investments in the securities of a portfolio company, such as the due diligence conducted before investment.

- A requirement to provide, on request, confirmation of whether the in-scope entity has maintained an account for, or engaged in transactions with, a specified person suspected of engaging in money laundering or terrorist financing.

Apart from the rules on suspicious transaction reporting, the AML/CFT Rules do not generally apply to an in-scope entity's activity with certain other persons that it advises. These are mutual funds, bank- and trust-company sponsored collective investment funds and other investment advisers (e.g. in a sub-advisory arrangement) provided that the other person is itself subject to the relevant AML/CFT Rules.

The new rules come into effect on **1 January 2026**.

11 ENFORCEMENT

ITEMS COVERED IN THIS SECTION

OVERVIEW OF FCA ENFORCEMENT

WHAT IS THIS? An overview of FCA enforcement activity.

WHO DOES THIS APPLY TO? Mainly FCA authorised firms and persons working in those firms but also may be relevant to non-authorised persons.

WHEN DOES THIS APPLY? Not applicable.

The FCA enforcement team could be forgiven for feeling a little battered at the end of 2024. Their proposals to publicise enforcement investigations have been much criticised (see Publicising Enforcement Investigations) and they also committed to make changes to their disclosure practices in enforcement cases following criticism in *Seiler and others v The FCA [2023] UKUT 00133 (TCC)*.

However, there was also more positive news for the FCA enforcement team with the Court of Appeal upholding its power to impose a requirement on firms to pay redress to clients. This followed the FCA's enforcement decision in 2021 in respect of BlueCrest Capital Management (UK) LLP (**BlueCrest**) which found that there had been conflicts of interest failings and imposed a requirement on BlueCrest to pay redress to clients who had suffered loss as a result of those failings. BlueCrest had challenged the FCA's power to impose that requirement.

The FCA also showed that it is still willing to take action in respect of non-financial misconduct even before any formal rule changes. It issued a Final Notice to Ari Harris prohibiting him from performing regulated activities on the basis that he was not a fit and proper person following a conviction for grievous bodily harm which he also failed to disclose to the FCA (as well as providing false and misleading information to the FCA).

Other key enforcement action by the FCA in 2024 included:

- Starling Bank Limited was fined £28,959,426 for failings in its anti-money laundering and financial sanctions framework. These included breach of a requirement from the FCA not to open any new accounts for higher risk customers, an automated screening system which had only been screening the names of customers against a fraction of the names on the financial sanctions list and wider systemic issues in respect of financial sanctions risk assessments, screening systems and management information. Metro Bank plc was also fined £16,675,200 as a result of failings in its automated system for monitoring customer transactions including inadequate processes to check the completeness of data entered or to deal with rejected data.

- H2O AM LLP, an authorised fund manager, was publicly censured for breaches relating to inadequate procedures and policies as well as making misleading statements and falsifying documents. The FCA found that H2O had failed to carry out proper due diligence on investments and had also failed to disclose the receipt of hospitality received by H2O employees. The FCA did not impose a fine as the French regulator, the *Autorité des marchés financiers*, also imposed a penalty and H2O committed to making EUR 250 million available to investors.

- Citigroup Global Markets Ltd was fined £27,766,200 for weaknesses in its trading controls. There was also a separate fine of £33,880,000 from the PRA. This followed an inputting error which led to over £1 billion of erroneous orders.

- PricewaterhouseCoopers LLP was fined £15 million for failure to report suspicions of fraudulent activity at London Capital & Finance plc while acting as auditor. This was a breach of its obligations under Regulation 2 of the Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2001 and was the first time the FCA had fined an audit firm.

- Kristo Käärmann was fined £350,000 for failing to notify the FCA of a significant financial penalty from HMRC. He had been fined by HMRC for failing to declare a disposal of shares and pay the resulting capital gains tax liability within the prescribed time period. Mr Käärmann held SMF 1 (Chief Executive) and SMF 3 (Executive Director) senior manager roles and the failure to notify the FCA was found to be a breach of Senior Manager Conduct Rule 4 which requires that individuals disclose appropriately information of which the FCA would reasonably expect notice (the first time the FCA has successfully enforced a Senior Management Conduct Rule). According to the FCA, this includes any matters that may be significant to a senior manager's fitness and propriety including matters that may have an adverse impact on their reputation or that of their firm.

Looking ahead to 2025, the FCA has said that financial crime is a key priority and there are reports that the FCA is surveying firms on their use of WhatsApp (which has also been an area of concern for non-UK regulators).

The FCA has also launched targeted action against finfluencers making financial promotions to their followers on social media including bringing criminal charges against nine individuals in relation to an unauthorised foreign exchange trading scheme promoted on social media.

It is also likely that the FCA's scrutiny of firms' compliance with the Consumer Duty could lead to enforcement action in due course.

PUBLICISING ENFORCEMENT INVESTIGATIONS

WHAT IS THIS? FCA proposals to announce publicly that it has opened an enforcement investigation if it considers that it is in the public interest to do so.

WHO DOES THIS APPLY TO? Mainly FCA-authorised firms but also other financial market participants.

WHEN DOES THIS APPLY? Not yet known.

The FCA published CP24/2: Our Enforcement Guide and publicising enforcement investigations – a new approach in February 2024 and it is fair to say that the proposals in that consultation have proved controversial.

The FCA proposed that it would publicly announce that it has opened an enforcement investigation if it considers that it is in the public interest to do so (including a relatively broad set of factors for assessing "public interest"). The FCA's proposals in CP24/2 included the following points:

- The FCA announcement would usually include the identity of the subject of the investigation and a summary of the suspected breach, failing or other misconduct being investigated.

- The subject of the investigation would be given up to one business day's advance notice (where possible) with a more tailored procedure for potentially market sensitive announcements.

- Due to data protection implications, the FCA would not generally publish the names of specific individuals.

The proposals raised significant concerns in the financial services industry and also within government. The then Chancellor of the Exchequer, Jeremy Hunt, criticised the proposals, as did the House of Lords' Financial Services Regulation Committee which thought that they would have a disproportionate effect on firms which are subsequently cleared of any wrongdoing, unfairly tarnish reputations and risk the overall integrity of the market.

The FCA appeared surprised at the strength of feeling against its proposals. In November 2024, representatives from the FCA gave evidence to the House of Lords' Financial Services Regulation Committee defending the proposals and stating that, in practice, it was expected that relatively few additional investigations would be announced.

The FCA followed this up by issuing a second consultation: CP24/2, Part 2: Greater transparency of our enforcement investigations which introduced a few tweaks. These included:

- The public interest test would include consideration of the potential negative impact on a firm and the potential for an announcement to seriously disrupt public confidence in the financial system or the market.

- Firms would be given at least 10 business days' notice ahead of any announcement and would be able to make representations during this period. If the FCA decides to announce, firms would then have an additional 48 hours' notice before publication.

The FCA also clarified that it would not announce investigations which began before the proposals come into effect but may reactively confirm investigations which are already in the public domain where this is in the public interest.

The consultation closes on **17 February 2025** and the FCA is expected to take a final decision on how to proceed in Q1 2025.

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