SHEARMAN & STERLING

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A Boost for U.K. Financial Services

The U.K. Financial Services and Markets Act 2023

The U.K.'s newest Financial Services and Markets Act of 2023 ("FSM Act") received Royal Assent on 29 June 2023. Certain parts came into force on its passing, others will come into effect two months after that, and the remainder will enter into force in accordance with regulations to be made. The first commencement regulations were made on 10 July 2023[1] (the Commencement Regulations), bringing into immediate force certain provisions, and others from 29 August 2023 and 1 January 2024. Further such commencement regulations are expected.

The FSM Act brings about numerous changes to U.K. financial services law across a wide range of areas and triggers a further implementation phase of the government's post-Brexit Future Regulatory Framework Review and the Edinburgh Reforms.[2] It revamps the existing regulatory model under the Financial Services and Markets Act 2000 ("FSMA") and provides a framework for the revocation of retained EU law ("REUL") in financial services. It gives new delegated powers to the U.K.'s regulators for detailed rulemaking, subject to enhanced oversight by Parliament and HM Treasury. The FSM Act also contains new provisions on a broad range of issues, all discussed in this note, including regulatory accountability, sustainability and environmental matters, a revamp of the U.K.'s legacy MiFID II and securitisation rules, a new regulatory framework for stablecoins and cryptoassets, financial market infrastructure, insurance and alternative investment fund regulation and consumer protection rules, including on access to cash at ATMs.

In this client note, we provide an overview of the FSM Act. We also discuss the main changes that were introduced to the Financial Services and Markets Bill ("FSM Bill") and catch up on developments since publication of the Act.

Revocation of Retained EU Law

The FSM Act creates the framework for implementing the government's post-Brexit policy of revoking financial services REUL, establishing a separate process for the revocation or replacement than that provided for in the Retained EU Law (Revocation and Reform) Act 2023.

Creating the concept of "EU-derived legislation," the FSM Act revokes most REUL for financial services, including the statutory instruments that amended REUL in the "onshoring" process. The revocation clause is only effective upon regulations being made. The Commencement Regulations revoked, from 11 July 2023, the Money Market Funds Regulations 2018[3] and certain provisions of the Sustainable Investment Regulation that require Treasury to make regulations. Further, the Commencement Regulations provide for the repeal of 98 statutory instruments on 29 August 2023, although many of these are regulations that were passed to amend separate U.K. legislation or REUL to ensure they remain operable post-Brexit. Accordingly, that legislation has achieved its purpose already and therefore the legal effect of these revocations is limited. Further revocations are provided for from 1 January 2024 including the European Long-Term Investment Funds

Regulation, the related SI and tertiary legislation,[4] and revoking a provision from the Capital Requirements Regulation so as to allow the Bank of England ("BoE") more flexibility to set internal Minimum Requirements for Own Funds and Eligible Liabilities for U.K. subsidiaries of non-U.K. global systemically important banks.

The list of revoked law is set out in Schedule 1 to the FSM Act and includes many EU Regulations, for example, the Markets in Financial Instruments Regulation ("MiFIR")[5], the Short Selling Regulation,[6] the European Market Infrastructure Regulation ("EMIR")[7], the Central Securities Depositories Regulation ("CSDR")[8], the Capital Requirements Regulation[9], the Market Abuse Regulation[10], the Prospectus Regulation, the Packaged Retail and Insurance-Based Investment Products ("PRIIPs") Regulation[11] and the Sustainability Disclosures Regulation[12] - and U.K. subordinated legislation that implemented EU Directives, such as the Settlement Finality Regulations[13], the Payment Services Regulations[14], the Alternative Investment Fund Managers Regulations[15] and the Bank Recovery and Resolution Order.[16]

HM Treasury has set a clear path for implementation of the revocation and restatement process which will occur over several phases.[17] The government will divide the legislation listed in Schedule 1 of the FSM Act into different tranches, and prioritize the revocation and replacement of those where new legislation will most benefit the U.K. The first of these have been identified as the Prospectus Regulation[18], the Securitisation Regulation,[19] the Data Reporting Service Regulations 2017[20] and the Solvency II Directive.[21] Draft statutory instruments and policy notes have been published for each of these and the government intends to lay the legislation before Parliament before the end of the year (subject to Parliamentary timings). Details of these draft SI are discussed below.

A new SI extends the powers of the Financial Conduct Authority ("FCA") and the Payment Systems Regulator ("PSR") in the payments area to ensure that they have the appropriate powers in relation to retained EU payments law.[22]

New UK Regulatory Architecture

The FSM Act implements the government's policy of establishing a comprehensive set of U.K. legislation for financial services. The U.K. traditionally had its own financial services statute covering all sectors, but this was added to by the U.K.'s sector-by-sector approach to implementing EU Directives, and the direct effect of EU Regulations (which were later onshored into U.K. domestic law following Brexit). The U.K. government's policy is to revert to a universal model based upon a single coherent and consolidated legislative framework.

This has been accomplished by bringing some areas currently covered by REUL into the FSM Act, transferring the responsibility for making detailed rules to the U.K.'s regulators and strengthening Parliament's oversight of the regulators. Transferring the detailed rules to the U.K. regulator's rulebooks will allow for a nimbler approach by expert regulators, compared to the EU process in which considerable detail was found in Directives and Regulations made by the EU's legislative bodies (at a level traditionally dealt with in the U.K. in regulator rulebooks, not statutes), making it harder to amend or address unforeseen consequences.

The FSM Act also grants new rulemaking powers to the U.K.'s regulators for those areas where they did not previously have such powers. For example, a general rule-making power is given to the BoE in respect of central counterparties ("CCPs") and central securities

depositories (“CSDs”) and the FCA will have the power to make rules for Data Reporting Service Providers (“DRSPs”) and Recognised Investment Exchanges (“RIEs”).

The Designated Activities Regime

The FSM Act creates a new “Designated Activities Regime” (“DAR”) for the regulation of activities related to the financial markets. The DAR sits alongside the regulated activities regime for specific regulated financial services. Designated activities are those activities in respect of which financial services rules will apply, but where the person carrying on the activity does not need a regulatory authorisation. This gives statutory force to the regulators making rules applicable to firms other than authorised (regulated) financial institutions.

The DAR, which comes into force on 29 August 2023, will operate in a conceptually similar way to the existing regime for regulated activities under the Regulated Activities Order (“RAO”), in the sense that HM Treasury is empowered to designate activities relating to financial markets and exchanges, and to designate instruments, products or investments. However, unlike the RAO model, HM Treasury is able to set certain requirements directly and then provide for certain areas to be covered by the FCA’s rules. The FCA is only able to make rules relating to specific designated activities; its remit will not extend to the wider unrelated or unregulated activities of those carrying out a designated activity, making it a narrower scheme than that for authorised firms. A person carrying on a designated activity must comply with the applicable requirements in the DAR or regulator’s rules unless there is an applicable exemption.

Schedule 3 of the FSM Act creates a new Schedule 6B to FSMA, which sets out the initial activities that will become designated activities from 29 August 2023 (under the Commencement Regulations), which are:

- Activities related to entering into derivatives contracts and holding positions in commodity derivatives.
- Short selling.
- In a securitisation, acting as an originator, sponsor, original lender or a securitisation special purpose entity and selling a securitisation position to a U.K. retail client.
- Offering securities to the market and admission of securities to trading on a securities market.
- Using a benchmark and contributing to a benchmark.

This brings under U.K. legislation various requirements on non-financial companies covered presently by the U.K.’s onshoring of the EU’s EMIR, the Short Selling Regulation, Securitisation Regulation, Prospectus Regulation, Transparency Directive[23] and Benchmark Regulation[24].

HM Treasury will be able to designate further activities. The FSM Act clarifies that cryptoassets may be considered to be instruments, products or investments. This change was adopted during the passage of the FSM Bill. The government has further proposed to regulate the activities of admitting (or seeking the admission of) a cryptoasset to a cryptoasset trading venue and making a public offer of cryptoassets (including Initial Coin Offerings).[25] We discuss cryptoasset regulation under the FSM Act below.

<u>The New Public Offers and Admission to Trading Regime</u>

The proposed Prospectus SI[26] will implement the government's policy to revise the existing prospectus framework and will:

- Introduce a new framework for public offers, consisting of a general prohibition on public offers of securities with a number of exceptions e.g., for securities admitted to trading on a U.K. regulated market or MTF.
- Enhance the FCA's powers to make rules for the admission of securities to trading on U.K. regulated markets, and hand additional powers to the FCA currently contained in the onshored Prospectus Regulation; for example, requirements relating to prospectus content, persons responsible for a prospectus and withdrawal rights etc.
- Grant the FCA rulemaking powers over "primary" MTFs (i.e., those which operate as primary markets, allowing companies to issue new capital), including requiring an "MTF admission prospectus" for issuances on primary MTFs open to retail investors and, in relation to "retail or non-retail" primary MTFs, requirements on the admission prospectus responsibility, withdrawal rights and the application of the prospectus advertising regime. Primary MTF operators will be responsible for setting specific content requirements for MTF admission prospectuses when an admission prospectus is required (otherwise than by the FCA in the case of "retail" primary MTFs) and the process for approving prospectuses.
- Revise the liability threshold for certain categories of forward-looking statements in prospectuses to one based on fraud or recklessness in the preparation of prospectuses and or statements made for admission to MTFs.
- Revise the regime for public offers of securities that are not admitted to trading. The existing prospectus regime requires public offers of €8 million or more to be accompanied by a prospectus (unless certain exemptions apply, such as offers to sophisticated investors or to fewer than 150 natural persons, etc.). This has tended to restrict those willing to raise capital above this threshold. Under the new rules, no prospectus will be required, but offers of £5 million or more must be made through a public offer platform (or rely on other exemptions, many of which reflect the exemptions currently available under the existing regime). Operating a public offer platform will become a new regulated activity.
- Bring certain non-transferable securities within the scope of the new regime for public offers if they are not otherwise subject to appropriate supervision and may cause harm to investors. Offers of such securities over £5 million must be made through a public offer platform. HM Treasury and the FCA have implemented certain other changes to the regulation of non-transferable securities in the wake of the London Capital & Finance scandal, in which 11,500 retail investors lost around £237 million investing in such products issued by the alleged Ponzi scheme.[27]

Responses to the draft Prospectus SI can be submitted until 21 August 2023. The FCA has published a series of engagement papers[28] relating to the new prospectus regime, responses to which may be submitted by 29 September 2023. The FCA will provide feedback on those in Q4 2023.

The Lighter-Touch Short Selling Regime

HM Treasury has published its Short Selling Regulation review response,[29] following a call for evidence published in December 2022. The Treasury plans to:

- Increase the net short position disclosure threshold from 0.1% to 0.2%.
- Replace the existing requirement to publicly disclose all short positions over 0.5%, which reveal the identity of the short seller, with an aggregated short positions disclosures model. Under the new regime, the FCA will aggregate and publish short positions in the shares of each company, giving the market a clearer view of short positions for each issuer but keeping individual net short positions private. Individuals will still be required to report short positions of 0.2% or above to the FCA, but they will not be identified in any public disclosures.
- Enable the FCA to make rules:
    - About exempt share arrangements (i.e., shares principally traded overseas), including moving to a "positive" list of shares that are within scope of the U.K. Short Selling Regulation, rather than the current "negative" list of shares that are out of scope (which suffers from not being updated regularly enough, resulting in disclosures that should otherwise not be required).
    - Streamlining the market maker exemption requirements, taking into consideration, among other things, industry calls to reduce administrative burdens for firms when submitting exemptions.
    - Prohibiting uncovered short selling.
- Require the FCA to set out its approach on using emergency intervention powers under the U.K. Short Selling Regulation, which in HM Treasury's view should only be used in exceptional circumstances. The FCA will consult on its approach in due course.

Several of these proposals will be positive for the industry, contributing to a more efficient and effective regime that is less onerous for firms from an administrative perspective. The changes, however, have not yet been implemented and for the time being, firms should continue with their normal short position calculations and filings. Further detail will be set out in a draft statutory instrument (to be published before the end of 2023) and FCA rules, which will be consulted on in 2024. No further indication is provided on timing for the effective date of the new regime.

HM Treasury has separately published a consultation[30] on sovereign debt and credit default swaps under the Short Selling Regulation. The Treasury is proposing to scrap all Short Selling Regulation requirements for short positions in sovereign debt and sovereign CDS, which the U.K. has long argued have the potential to negatively impact liquidity in sovereign debt markets. Under the proposals, the FCA would retain power to intervene in sovereign debt and CDS markets in exceptional circumstances, including powers to request information or ban short selling of instruments. Responses to the consultation may be submitted until 7 August 2023.

New oversight powers over unregulated "critical third parties"

In parallel with the designation regime, the regulators will have new direct powers over third parties that provide critical services to authorised firms, their service providers and FMIs.

These regulatory powers have until now been limited. From 29 August 2023 (per the Commencement Regulations), HM Treasury is able to designate an entity as a "critical third party" if its failure would pose financial stability or confidence risk to the U.K. In addition, the Commencement Regulations bring into force, from 29 August 2023, the powers of the FCA, Prudential Regulation Authority ("PRA") and BoE, among other things, to:

- make rules governing the services those critical third parties provide to authorised firms, relevant service providers and FMIs;
- direct critical third parties to, or prohibit critical third parties from, taking certain actions;
- publicly censure a critical third party for rule breaches;
- impose disciplinary measures against the critical third party, including banning them from providing their services to regulated entities, preventing authorised firms, relevant service providers and FMIs from availing themselves of services from the critical third party and imposing conditions on the provision of the critical third party's services. The regulators are required to publish a policy statement on how they intend to use their disciplinary powers.

The BoE, PRA and FCA are expected to consult this year on their proposed requirements and expectations for critical third parties, taking into account responses to their 2022 discussion paper and related survey.[31]

Regulatory Accountability

The additional rulemaking responsibility for the regulators significantly increases their powers. How and whether those powers should be constrained or overseen has been subject to much debate. The FSM Act makes provision to strengthen the regulatory accountability framework. HM Treasury will be empowered to require either the PRA or FCA to make rules but may not specify the content or outcomes that such rules should seek to accomplish. HM Treasury is also empowered to require a regulator to review its rules (or appoint an independent reviewer) where HM Treasury considers it is in the public interest, for example, in response to market developments or if the rules do not appear to realise their purpose. The regulators will be required to keep their rules under review and to publish a statement of policy on how they conduct such reviews. These provisions were amended during the legislative process to provide that the policy statement must state how representations can be made to the regulator and how those representations will be considered. The PRA is consulting[32] on its proposed approach to reviewing its rules, including a proposed statement of policy. Responses to the consultation may be submitted until 29 September 2023. The FCA has also published its draft Rule Review Framework[33] for comment.

The PRA and FCA must also notify relevant Parliamentary Select Committees when they launch a consultation on proposed rules, publish proposals on how they exercise their general regulatory functions or consult on proposals under a duty imposed by legislation. The FSM Act requires the regulators to respond in writing to any formal response to a consultation by a Parliamentary Committee.

The original provisions introducing the requirement for each regulator to appoint a Cost Benefits Analysis Panel have been maintained in the final FSM Act. Those panels will now need to include at least two individuals from two different authorised firms. Furthermore, this panel, and others that are required to be established, may not include any individuals that are remunerated by the FCA, the PRA, the BoE, the PSR or HM Treasury. Strengthening industry involvement and instilling independence in the cost-benefit aspect of consultation processes are auspicious additions to the FSM Act.

These provisions will apply from 29 August 2023 under the Commencement Regulations.

New Growth and International Competitiveness Secondary Objective

The FSM Act introduces a new secondary statutory objective, obliging the FCA and PRA in carrying out their functions to support the long-term growth and international competitiveness of the U.K.'s economy in the medium and long term. This obligation is in force from 29 August 2023, under the Commencement Regulations.

For the PRA, the new growth and international competitiveness objective will operate in conjunction with its existing secondary objective to facilitate effective competition in the markets for services provided by PRA-authorised firms (being banks, large investment firms, insurers and credit unions). For the FCA, the new objective will go together with the FCA's three existing operational objectives of consumer protection, market integrity and competition. It is hoped that this new objective will provide motivation for the FCA in particular to improve on its slow turn-around times for new business for authorisations and other regulatory processes.

There is a duty (introduced during the Bill's passage) on each of the regulators to report at two intervals to HM Treasury setting out how it has complied with its duty to advance the new objective. The reports are due 12 and 24 months after the new objective applies (29 August 2024 and 29 August 2025 respectively. Each regulator must already report annually to HM Treasury on, among other things, how it has advanced its objectives. Furthermore, HM Treasury is empowered to issue a direction at any time requiring a regulator to report on, among other things, how it has advanced its objectives, discharged its functions and considered the applicable regulatory principles.

HM Treasury is currently able to recommend to each regulator that it takes into account the government's economic policy when considering how to comply with its strategic and operational objectives. This power will now extend to how the regulator discharges its duty to advance the new growth and international competitiveness objective.

Both of the regulators will also need to provide information to relevant Parliamentary Committees regarding how any of their proposals that are subject to consultation will advance the new secondary objective.

The FCA has recently published a statement[34] setting out how its work to support the 'key drivers' of productivity will aide delivery of this new secondary objective and how it intends to report on progress embedding the new objective.

New Net Zero Regulatory Principle

There is a new regulatory principle requiring the FCA and the PRA to have regard to the need to achieve the U.K.'s statutory climate target, which is in force from 29 August 2023 according to the Commencement Regulations. During the passage of the FSM Bill, that obligation was extended to include the conservation and enhancement of the natural

environment, which extended part will come into effect at a later date once the regulators have considered how they will operationalise the obligation.

To avoid duplication, the FSM Act removes the existing sustainable growth principle for both regulators. The PSR's objectives are not changing and therefore its sustainable growth principle will remain; however, the net zero regulatory principle will be integrated into that sustainable growth principle. This change will apply from 29 August 2023 under the Commencement Regulations.

New Financial Inclusion factor

Going forward, the FCA, in considering the degree of consumer protection that is appropriate, will need to take into account financial inclusion. This is an additional consideration for the FCA that was not included in the original FSM Bill.

Financial Regulators Complaints Commissioner

Regulatory accountability became a controversial topic during the passage of the legislation. Following heated debates and numerous amendments proposed on this topic during the Parliamentary process, the FSM Act introduces amendments to the Financial Services Act 2012 which will, from 29 August 2023, bolster the powers of the Financial Regulators Complaints Commissioner ("FRCC") and enhance its independence. The FRCC reviews complaints about the actions or inactions of the U.K.'s financial services regulators (the FCA, PRA, PSR and, on certain issues, the BoE).

These amendments stem from those tabled in the House of Lords by Lord Peter Lilley, which themselves are based upon work and consultation led by Shearman & Sterling, involving a diverse set of stakeholders, including leading barristers, regulated firms and advocacy groups. Market participants have previously voiced concerns that the FCA and PRA are not subject to effective or sufficient controls or balances.[35] These concerns were heightened by proposals under the FSM Bill (which have since passed into the FSM Act) to transfer significant new rule-making powers to the U.K.'s regulators, since an effective check and balance on those new powers was needed.

The need for reform over the FRCC's role was recently highlighted following a challenge to FCA rulemaking in its "Remedies Statement,"[36] in which the FCA sought to introduce new principles governing its own liabilities to consumers. The FRCC found the Remedies Statement to be inconsistent with statute and to have been introduced without following the correct process.[37] However, the FCA ignored the FRCC's findings and even today the FCA Remedies Statement still stands as published. The FCA has now gone one step further and enshrined a key principle of the criticised Remedies Statement in its revised formal Complaints Scheme, which will take effect from 1 November 2023 and which the regulators (namely the FCA, PRA and Bank of England) are obliged to follow.[38] The FCA's actions show it was clearly unsustainable to foist new rulemaking powers on the FCA when it had recently been found to have introduced rules unlawfully and then to have ignored the relevant findings of the FRCC.

Following the amendments, the FRCC will be appointed by and accountable to HM Treasury (as opposed to the regulators, as was previously the case). The regulators will also have to explain themselves where they do not accept the FRCC's recommendations. The FCA will have to summarise the cases in which it has decided not to follow the FRCC's recommendations and give reasons for not doing so. This reasoning will be laid before Parliament, together with the FRCC's annual report. HM Treasury will also be granted a new

power to specify additional matters that should be included in the FRCC's annual report, contributing to greater accountability for the regulators.

Rulemaking without consultation

Another change relating to regulatory accountability from the Parliamentary process involves a new requirement for regulators to publish a statement where they make changes to rules without consultation, with particular regard to the development of legacy EU laws. In such a statement, the regulators must now set out the provisions of legislation that have been restated, describe how EU obligations have been amended by rules and specify the EU obligations that have been removed through revocation. Furthermore, where there have been material amendments that only reduce regulatory burdens, the regulators must explain how the proposed rule changes are consistent with their objectives, including the new growth and international competitiveness secondary objective. A regulatory burden for these purposes includes, but is not limited to, a financial cost, an administrative inconvenience, an impediment to trade or innovation or to efficiency, productivity and profitability.

Sustainability and Green Economic Reforms

Sustainability Disclosure Requirements

Under the FSM Act, HM Treasury is entitled (though not obliged) to prepare a policy statement on sustainability disclosure requirements. Sustainability is defined broadly for these purposes, including matters relating to: (i) the environment (including climate change); (ii) social, community and human rights issues; (iii) tackling corruption and bribery; and (iv) governance in relation to the prior three matters. The FSM Act requires the Treasury to consult the FCA and PRA when preparing the policy statement and to keep it under review. The regulators will then need to have regard to the policy statement when preparing any of their own rules or guidance on sustainability disclosures. They will also need to publish statements in their annual reports on how they have complied with this obligation.

Forest risk commodities

Forest risk commodities are those derived from plant, animal or other living organisms, the production of which involved the conversion of forest into agricultural land. The Government is yet to pass legislation specifying the commodities that fall within this provision, but they are expected to include products such as beef, leather, cocoa, palm oil, rubber and soya. Under a new provision introduced at a late stage of the FSM Bill's progress, HM Treasury is required to conduct a review into how well U.K. financial regulation is equipped to eliminate financing of the use of these "forest risk commodities" and publish a report setting out its conclusions and the steps it proposes to improve U.K. financial regulation for these purposes. These obligations will apply from 29 August 2023 under the Commencement Regulations. The forest risk commodities provision is substantially diluted from the original FSM Bill drafting, which had envisaged a prohibition on regulated activities that supported commercial activities relating to forest risk commodities (or products derived from those commodities), unless relevant local laws were complied with, and imposed due diligence obligations.

MiFID II-Based Rules - Reforms for Wholesale Markets

The U.K. originally "on-shored" the Markets in Financial Instruments Regulation into U.K. law as REUL with only minor amendments following its exit from the EU. The FSM Act includes a new set of amendments that aim to tailor this unwieldy package of European measures for the U.K. market. The changes, made through a transitional regime rather than the revocation route, herald some welcome relief to those acting in the wholesale markets, with the reduction of some of the more burdensome requirements across a raft of areas regulated under the U.K.'s Markets in Financial Instruments package, as prefaced by the Wholesale Markets Review[39] (which we discuss in our related client note here).

The changes will enter into force once implementing regulations are made. The Commencement Regulations provide for some of these amendments to apply from 29 August 2023, as we indicate in our discussion below. It is hoped that HM Treasury will give priority to the remaining significant measures and bring in a further commencement regulation soon.

Many in the industry would also be encouraged by the recent government announcement[40] that the rules on unbundling on research may be removed. This follows the recommendations of the UK Investment Research Review,[41] which included that there should be more options available for paying for investment research so that U.K. asset managers can pay for research on a bundled basis and also ensure that they can obtain research from other jurisdictions, particularly the U.S. In our client note "MiFID II and the US Investment Adviser Regime", we discuss the impact of the EU and U.K. rules on unbundling of research on U.S. broker-dealers, particularly in light of the end on 3 July 2023 of the temporary relief given by the Staff of the Securities Exchange Commission that allowed brokers to provide execution and research services on a MiFID II-compliant basis without being regulated as an investment adviser.

We set out here the main changes to be brought about to the U.K. MiFID II package and also note some of the proposed changes to the EU's MiFID II regime, highlighting divergence between the two adjusted regimes.

Commodities Derivatives Markets and Position Limits

The MiFID II requirement for commodities position limits to be applied to all exchange-traded contracts and over-the-counter, or non-venue traded ("OTC"), contracts that are economically equivalent to exchange-traded commodity derivatives, is revoked. The powers for setting position controls are transferred from the FCA to the operators of trading venues, reflecting the *status quo ante* under MiFID I. However, the FCA has discretion to determine the contracts for which trading venues will be required to set position limits. The FCA will continue to set limits directly for OTC contracts, if needed, and will have new powers to establish a framework to support trading venues in setting position limits. The FCA will launch a consultation on these aspects in Q4 2023.

The EU's amended commodities position limits regime has applied since 28 February 2022.[42] The main changes were to: (i) narrow the regime to non-agricultural commodity derivatives that are deemed significant or critical commodity derivatives and their economically equivalent OTC contracts; (ii) introduce an exemption for market makers; and (iii) exclude securitised derivatives from the regime.

Fixed Income and Derivatives Markets

MiFID II imposes a "trading obligation," requiring mandatory on-venue trading of some derivatives. However, changes made by the EU in 2019 to the scope of the related clearing

obligation in EMIR were not reflected in the MiFID II trading obligation. This led to a mismatch in the scope of parties captured by the trading and clearing obligations. To eliminate this, the FSM Act aligns the scope of parties subject to the trading obligation and clearing obligation and explicitly makes counterparties that fall within the scope of the clearing obligation subject to the trading obligation. Under the Commencement Regulations this change will come into force on 29 August 2023. The EU is also aligning the scope of its derivatives clearing and trading obligations, and the European Commission will be empowered to suspend the derivatives trading obligation in certain circumstances.[43]

The FCA has a new power to make changes to the trading obligation, where necessary, to prevent or mitigate disruption to markets, subject to HM Treasury's approval.

Firms that use the risk reduction measure of portfolio compression are currently exempt from certain obligations, including the trading obligation, best execution requirement and transparency obligations. To further encourage the use of risk reduction measures, the FSM Act grants the FCA powers to specify other risk reduction services that can benefit from these exemptions. The BoE is also granted powers to exempt such services from the clearing obligation where the BoE considers it necessary or expedient for financial stability purposes. Risk reduction services are post-trade services that aim to reduce non-market risks in derivatives portfolios, such as portfolio compression. Transactions that contribute to the price discovery process are excluded.

The MiFID II pre- and post-trade transparency regime, previously set out in primary legislation, is now delegated to FCA rulemaking. The regulator will make rules to provide for a qualitative and quantitative assessment of instruments that should fall within the regime, determine when and how pre-trade transparency requirements should apply and establish a post-trade transparency regime. FCA proposals are expected to be published in Q4 2023.

Trading Venues

The Wholesale Markets Review proposed a range of changes to the rules governing trading venues. The FSM Act delegates the pre-trade equity waivers regime to the FCA. The following are still expected from the FCA:

- FCA rules enabling OTFs to execute transactions in packages involving derivatives and equities;
- FCA rules allowing matched principal trading by an MTF, conducted under clear, transparent and nondiscretionary rules; and
- FCA guidance for market operators and participants to follow when there is a market outage, and alternative mechanisms to a closing auction during market outages. The FCA has established a sub-committee within its Secondary Markets Advisory Committee to develop good practice for trading venues and investors to ensure market resilience during outages.

The FCA has published final guidance[44] to clarify the scope of the regulatory perimeter for trading venues, which caters for new platforms emerging from technological developments.

In addition to providing guidance on the regulatory perimeter and how this applies to different business models, with issuing this guidance, the FCA confirms that Q&As 7, 10, 11 and 12 in section 5 of the European Securities and Markets Authority's Q&As on MiFID II and MiFIR market structures topics[45] no longer form part of its supervisory expectations. Earlier this year ESMA issued its own opinion on the trading venue perimeter.[46] The ESMA paper endorsed the same four-pronged test for determining if a given offering is a "multilateral system" as the FCA. ESMA has expressed some different views to the FCA with regard to the perimeter; for instance, ESMA guidance would appear to draw in more RFQ systems into the regulatory perimeter.

The U.K. government is also considering the introduction of a new type of trading venue (or an additional segment of existing trading platforms) tailored to the requirements of smaller SMEs. Proposals to lift the restriction on operating Systematic Internalisers ("SIs") within the same legal entity as OTFs are subject to further consideration.

Equity Markets

The FSM Act revokes two equity market restrictions derived from EU MiFID II, namely the:

- Share Trading Obligation ("STO"): shares admitted to trading no longer have to be traded on a U.K.-regulated market, MTF, SI or equivalent third-country venue by U.K. investment firms. These shares may be traded OTC or on any U.K. or overseas trading venue of a firm's choice. The EU is maintaining a revised version of the STO; it will be limited it to shares with an EEA International Securities Identification Number. In addition, the exemption for trades in shares that are non-systematic, ad-hoc, irregular and infrequent is being removed since it was unclear when it would apply. A new exemption will apply to shares traded on non-EU trading venues in a non-EEA currency.[47]
- Double Volume Cap ("DVC"): this limited the level of dark trading to a certain proportion of total trading in an equity but is replaced by an FCA obligation to monitor trading and new FCA powers to direct that transparency waivers should be suspended if the ongoing use of the waiver would impact market integrity. The EU is intending to simplify its DVC by replacing the existing two thresholds with a single threshold.[48]

The Commencement Regulation bring these changes into force on 29 August 2023.

Systematic Internalisers

SIs are investment firms that execute client orders on their own account on an organised, frequent systematic and substantial basis. A quantitative threshold is currently used to determine whether an investment firm must be authorised as a SI (e.g., based on the number and size of trades it conducts). Under the FSM Act, the quantitative tests have been abandoned in favour of empowering the FCA to make rules on whether firms satisfy the conditions for SIs. Those rules may, at the FCA's discretion, be entirely qualitative.

There will no longer be any restrictions on mid-point execution of client orders across an SI's own book. This changes the position under MiFIR, which since 2018 has restricted an SI's execution of orders at the mid-point between best bid and offer for all transactions other than those which were "large in scale."

These changes will apply from 29 August 2023 under the Commencement Regulations.

Consolidated Tape

MiFID II introduced requirements for a "consolidated tape" for transactions in equity and non-equity instruments. It requires a consolidated tape provider ("CTP") to collect post-trade information published by trading venues and approved publication arrangements and to consolidate this into a continuous live data stream made available to the public. No consolidated tape has yet been set up in either the U.K. or the EU. The EU announced[49] at the end of June 2023 that political agreement had been reached on the proposals to introduce an EU consolidated tape (we discussed the proposals in our blog "European Commission proposes revisions to MiFID II").

The U.K. intends to maintain these requirements to establish a consolidated tape. DRSPs, of which CTPs would be an example, are governed by the Data Reporting Services Regulations 2017 ("DSPRs"), and fell outside the scope of the FCA's authorisation regime. The FSM Act grants the FCA rule-making powers for DRSPs, which will (among other things) enable the FCA to set a framework for the development of a consolidated tape. The Act also permits the DSPRs to be repealed and replaced. As discussed under the REUL section above, it is a priority for the government to repeal of EU laws relating to DRSPs to facilitate the establishment of a CTP and HM Treasury has published a near-final draft SI and related policy note.[50] Comments on the draft SI may be submitted until 21 August 2023.

The FCA is currently consulting on proposals[51] for a consolidated tape for bonds. The FCA sets out its proposed framework (which allows for only a single CTP for bonds), criteria for how a CTP would operate and the tender process for appointing a CTP. Responses to the FCA's consultation may be submitted until 12 September 2023. The FCA states that it will finalise its rules for establishing a CTP by 2024, and issue the tender in 2024, aligning with the government's commitment to put a legislative and regulatory regime in place by 2024.

Securitisations

As confirmed in HM Treasury's report[52] on the review of the U.K. Securitisation Regulation (which we discuss in our post "HM Treasury Identifies Areas for Improving the UK Securitization Framework"), the FSM Act amends the U.K. Securitisation Regulation to introduce an equivalence regime for recognising non-U.K. securitisations as "simple, transparent and standardised" ("STS") securitisations in the U.K. Currently, the U.K. Securitisation Regulation provides that where originators and sponsors are established outside the U.K., the securitisation cannot be designated as an STS securitisation. This means that U.K. investors in such non-U.K. securitisations do not benefit from the preferential capital treatment accorded to U.K. STS securitisations. The Commencement Regulations bring these changes into force on 29 August 2023.

As discussed above, it is intended the retained EU Securitisation Regulation will be repealed and restated, with amendments. On 11 July 2023 HM Treasury published a near-final draft statutory instrument and a related policy note.[53] This follows the illustrative draft published in December 2022 as part of the government's Edinburgh Reforms.[54] The intended amendments to the Securitisation Regulation follow HM Treasury's review. The draft SI introduces a revised framework for regulating securitisations, which includes:

- Designation activities under the DAR. These are acting as an originator, sponsor, original lender, or Securitisation Special Purpose Entity ("SSPE"), and selling a securitisation position to a retail client located in the U.K. The FCA will be empowered to make rules governing these activities, covering both authorised and unauthorised firms, except PRA-authorised firms which will be subject to PRA rules.

- Repealing the detailed firm-facing requirements so that those can be housed in the regulator's rules.
- A new definition of "institutional investor" which removes non-U.K. Alternative Investment Fund Managers that market or manage AIFs in the U.K. from the scope of the due diligence requirements.
- Clarification of the scope of the prohibition on establishing SSPEs in jurisdictions considered high-risk or non-cooperative by the Financial Action Task Force.
- Reforms to the due diligence requirements for Occupational Pension Schemes.

Technical comments on the latest draft SI may be submitted until 21 August 2023. The final SI will be laid before Parliament before the end of the year. The PRA is consulting[55] on proposed rules that will replace retain EU law requirements on PRA-authorised firms. Responses may be submitted until 30 October 2023. The FCA has announced that it will publish its consultation on 7 August 2023.

Cryptoasset Regulation

HM Treasury has consulted extensively on how to regulate the fintech industry, in particular cryptoasset activities. The changes being brought in by the FSM Act represent the government's policy for regulating cryptoassets. We discuss the government's proposed approach in our client note: "UK Proposals for Cryptoasset Regulation". HM Treasury's final policy is awaited.

According to the Commencement Regulations, the below provisions will all apply from 29 August 2023. These provisions were added during the legislative process.

Cryptoasset Regulated Activities

The FSM Act makes the carrying on of certain cryptoasset activities a regulated activity, by clarifying that an investment includes any asset, right or interest that is a cryptoasset. This paves the way for HM Treasury, as it has proposed, to amend the RAO by adding cryptoassets to the list of specified investments, thereby bringing them into the regulatory perimeter. Once the RAO is amended, any natural or legal person carrying out certain activities involving cryptoassets "by way of business" will be performing a regulated activity and will need to be authorised by the FCA.

Cryptoasset Designated Activities

As mentioned above, the FSM Act clarifies that cryptoassets may be considered to be instruments, products or investments under the DAR.

Financial Promotion Restriction

The FSM Act also extends the financial promotion restriction to cryptoassets by clarifying that an investment includes any asset, right or interest that is a cryptoasset. This aligns the primary legislation in FSMA with the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, which was recently amended[56] to include qualifying cryptoassets. More detail on these legislative changes and changes to the FCA rules are available on our Financial Regulatory Developments Focus. The amended regime will apply from 8 October 2023.

Digital Settlement Assets, Including Stablecoins

The FSM Act provides for the provisions on "digital settlement assets" ("DSAs") to come into force on 29 August 2023, and the Commencement Regulations grant HM Treasury its powers from the same date.

The FSM Act brings DSAs into the U.K.'s regulatory perimeter for systemic payment systems and service providers. The scope of Part 5 of the Banking Act 2009 is extended to provide for the recognition of payment system using DSAs or a DSA service provider posing potentially systemic risks. DSA service providers will include the issuer of a DSA in a payment system, those providing services to safeguard and/or administer DSAs, DSA exchange providers, the firm setting the rules for access to the system and those involved in the transfer of money or DSAs using the payment system, including any infrastructure provider. HM Treasury is empowered to recognise the payment system using DSAs or a DSA service provider.

The BoE will supervise the operators of a DSA recognised payment systems, including issuing codes of practice, giving directions and taking enforcement action, among other things. The Act also gives HM Treasury power to amend, by secondary legislation, existing special administration regimes to cover recognised payment systems using DSAs or a DSA service provider, to preserve financial stability in the event of any such firm's failure.

HM Treasury will also be able to bring activities such as the issuance, custody or facilitation of the use of DSAs used as a means of payment into the U.K. regulatory perimeter and to establish a supervisory regime for stablecoin issuers, similar to the existing electronic money and payments regimes. Supervision of these activities will be undertaken by the FCA.

Initially, the regime is primarily intended to capture stablecoin activities. DSAs are defined as "a digital representation of value or rights, whether or not cryptographically secured, that—

a. can be used for the settlement of payment obligations,

b. can be transferred, stored or traded electronically, and

c. uses technology supporting the recording or storage of data (which may include distributed ledger technology)."

This new definition of DSAs has a broad scope that will cover stablecoins and may also cover other digital or cryptoassets that meet the terms of the definition. HM Treasury is able to amend the definition to account for future technological developments.

Under the Act, DSA payment systems are also subject to competition regulation by the PSR. HM Treasury will also be responsible for designating firms for these purposes.

Approach to Stablecoin Regulation

HM Treasury has concluded[57] that all stablecoins used for payment that reference fiat currencies, including a single currency stablecoin or stablecoin based on a basket of currencies, should be subject to U.K. financial regulation. Stablecoins that reference commodities will be excluded from the new rules, although such stablecoins may well already be regulated as futures.

In addition, the government intends the FCA to have the power to regulate issuers of stablecoins for payments as well as other entities providing related services, including wallet providers and firms providing custody services. The requirements will ensure convertibility

into fiat currency, at par and on demand. As with other entities providing payment services and e-money issuance, stablecoin-based payment service entities will need to be established in the U.K. to provide these services in the U.K.

Notably, consumers would have a legal claim to redeem the value of the token against either the stablecoin issuer or, where appropriate, the third party facing the consumer. This is necessary since often a stablecoin issuer may not offer holders a legal claim, leaving a customer with no redemption rights or with rights against a third party.

HM Treasury has also proposed an approach to managing the failure of DSAs,[58] which entails adjusting the existing FMI special administration regime ("FMI SAR"). Proposed changes to the FMI SAR include an additional objective for the return or transfer of funds and custody of assets and empowering the BoE to introduce further rules to support the additional objective as well as to direct administrators. The regime would take precedence over the Payment and E-Money Special Administration Regime ("PESAR") in cases where both the FMI SAR and the PESAR apply to a firm. HM Treasury policy statement is still expected.

Anti-Money Laundering and Politically-Exposed Persons

An addition to the FSM Act imposes on HM Treasury a duty to use its powers under the Sanctions and Anti-Money Laundering Act 2018 to amend the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the "MLRs") regarding politically exposed persons ("PEPs"). The objective is to reduce the customer due diligence measures required where a customer is a domestic PEP (i.e., a PEP entrusted with prominent public functions by the U.K.). Another change is to require the FCA to review its PEPs guidance for firms subject to the MLRs. The review must assess the extent to which the guidance is followed and whether the guidance remains appropriate. This may result in future consultations from the FCA. Both HM Treasury and the FCA are required to take the necessary actions within 12 months of the relevant provision entering into force, which was on the passing of the FSM Act.

Financial Market Infrastructure

FMI Sandboxes

The government is taking forward its plans to use FMI sandboxes to assess the existing legislative framework in a technologically-neutral manner. The FSM Act gives HM Treasury powers to establish individual sandboxes through statutory instrument and to temporarily modify certain legislation and rules and to disapply the existing requirements for FMIs approved for participation in an FMI sandbox. The intention is to obtain clarity about whether distributed ledger technology could be used to meet the same regulatory outcomes or whether its use will lead to legal ambiguity.

The risks involved in the operation of the FMI sandbox will be mitigated by limits on the amount and values of instruments permitted for an FMI activity. In addition, the regulators are empowered to monitor an FMI's sandbox activity and could suspend or terminate an FMI's participation in the sandbox.

The provisions on FMI sandboxes come into force on 29 August 2023 under the Commencement Regulations, including the provisions requiring Treasury to report on FMI sandbox arrangements and its powers to make permanent any arrangements tested under an FMI sandbox. HM Treasury is consulting[59] on the first FMI sandbox to be set up using its new powers, the Digital Securities Sandbox (or DSS). Responses to the consultation may be submitted until 22 August 2023. It is proposed that the DSS would facilitate firms in establishing and operating FMIs using digital asset technology and performing the activities of CSDs and trading venues in relation to existing security classes (either digitally native issuances or digital representations of existing securities). The BoE and FCA will also publish the application process, provide additional guidance and consult on rule changes.

FMI Senior Managers and Certification Regime

The FSM Act provides for the possible extension of the Senior Managers' and Certification Regime ("SMCR") to U.K. CCPs, CSDs, RIEs and credit rating agencies ("CRAs"). The FSM Act enables HM Treasury, after consulting with industry and the relevant regulators, to apply the regime to those FMIs. The government is able to decide when to apply the SMCR to any FMI entity and to tailor the regime according to the type of entity.

Powers to supervise SMCR compliance by CCPs and CSDs are granted to the BoE. The FCA is granted powers to supervise CRAs and RIEs. Both the FCA and the BoE are responsible for making detailed rules setting out the obligations of individuals within the regime, which will consist of a senior managers regime, a certification regime and conduct rules.

CCP Recovery and Resolution

The EU CCP Recovery and Resolution Regulation ("CCP RRR") came into effect post-Brexit and is not REUL. The U.K., when it was an EU member state, supported and helped develop the EU CCP RRR. The U.K. is therefore taking the opportunity of the FSM Act to introduce rules in this area, replicating some (but not all) aspects of the EU regime. The Act broadens the existing regime for the recovery and resolution of CCPs that are failing or have failed. The BoE, as U.K. resolution authority, will have additional powers to safely resolve a CCP, including to:

- Require a CCP to make changes to remove potential barriers to its resolvability.
- Temporarily halt any right to early termination of participation by a clearing member resulting from the CCP entering resolution.
- Take control of a CCP (without using its existing property or share transfer powers).
- Direct a CCP to remove or replace directors and senior managers and appoint temporary managers in severe circumstances.
- Return a failing CCP to a 'matched book' to ensure that it does not continue to be exposed to losses generated by the positions of the defaulting clearing member.
- Reduce (potentially to zero) the payments that a CCP would otherwise be required to make to clearing members whose positions have gained value.
- Write down unsecured liabilities to produce additional loss absorbing capacity.
- Delay enforcement of a clearing member's obligations in resolution if the enforcement during the resolution of a CCP presents a risk to financial stability (HM Treasury is given powers to make regulations to enable the BoE to use this).

- Require CCPs to hold a second tranche of "skin-in-the-game", requiring CCPs to hold more of its own capital for loss absorption.

The EU CCP RRR has fully applied since 12 February 2023. The above provisions of the FSM Act come into effect when implementing regulations are made.

Some amendments have been made since the FSM Bill was introduced, including regarding the preservation of obligations imposed by the BoE when exercising its powers to recover or resolve a CCP. The first stabilization option for a failing CCP would be sale to a private sector purchaser. Such sale could be effected by a share transfer instrument or a property transfer instrument, covering all or part of the business of the CCP. In this scenario, the BoE may confer and impose rights and obligations on a former group company or third party and the transferred CCP. An important change is to preserve the obligations imposed by the BoE where a relevant entity enters insolvency. Furthermore, those obligations are protected from any change by a liquidator under the Insolvency Act 1986.

Protecting the U.K. Wholesale Cash Infrastructure

As announced in April 2022 by HM Treasury,[60] measures to preserve the U.K. wholesale cash infrastructure have been brought in by adding a new Part 5A to the Banking Act 2009. HM Treasury is empowered to recognise firms as having market significance or systemic significance depending on their wholesale cash distribution activity, which generally means activities that facilitate or control the arrangements to make cash available for retail distribution and the removal of cash from circulation. The BoE is granted powers to oversee the wholesale cash industry to ensure it continues to operate effectively, including:

- Market oversight powers enabling the BoE to set objectives for designated entities, e.g., high-level principles (as approved by HM Treasury) and codes of practice for the operations of recognised firms. The BoE is also able to require recognised firms to provide information, which will assist the BoE in monitoring risks, and can impose requirements on individual firms by issuing directions.
- Prudential regulation powers allowing the BoE to exercise the same powers as under the market oversight regime but with the objective of managing financial stability risks. The BoE will also operate a SAR for use in the event that a recognised systemic firm became insolvent. Similar SARs already apply to banks and larger investment firms, however, this is a new regime intended for systemically important businesses in the wholesale cash industry not falling under those regimes.
- Enforcement powers under which a recognised firm may be penalized for failing to comply with a code of practice or direction. Where a compliance failure by a recognised systemic firm poses a risk to the U.K. financial system or have serious consequences for businesses throughout the U.K., the BoE may issue the firm with a closure notice, requiring it to cease performing certain functions temporarily, permanently or until further notice. Finally, the BoE has management disqualification powers to prohibit individuals from holding positions of responsibility in a recognised firm.

The FSM Act provides that these measures will apply from 29 August 2023.

Insurers in Financial Difficulties

The FSM Act clarifies the scope of liabilities that may be written down by the court pursuant to a "write-down order" under section 377A of FSMA, which replaces the current section 377 FSMA. HM Treasury, the PRA, the insurer itself or a shareholder, policyholder or other creditor of the insurer can apply to the court for a write-down order. The court may make a write-down order if it is satisfied that the insurer is, or is likely to become, unable to pay its debts and that the write-down is reasonably likely to lead to a better outcome for policyholders and creditors (taken as a whole) than not making the order. The write-down order cannot reduce the value of certain "excluded liabilities" (e.g., amounts payable in respect of wages or salary or under an occupational pension scheme).

One or more persons will be appointed as the write-down manager. The manager will be an officer of the court and must monitor the write-down's progress (always with a view to delivering a better outcome for policyholders and other creditors which, where appropriate, may include applications to court to vary or revoke the write-down order). The Financial Services Compensation Scheme will also be obliged to pay out where policyholders' payments have been reduced under a write-down. Except with the permission of the court, there will be a statutory moratorium on certain legal actions (including security enforcement) against the insurer for so long as the write-down is ongoing, commencing from the date of the application.

Where an insurer is subject to "financial difficulties" (i.e., where write-down or administration proceedings are in effect or a winding-up petition has been presented and remains outstanding), suppliers of goods or services to or counterparties to certain "financial contracts" with the insurer cannot exercise contractual provisions that terminate or allow for the termination of their contract due to the insurer's financial difficulties, or require the insurer to pay any outstanding charges as a condition of continued supply, without the consent of the court, relevant office-holder or (where there is no office-holder) the insurer. However, the court may order that the prohibition does not apply in certain circumstances, including where enforcing it would cause hardship to a person other than the insurer. It should be noted that the category of "financial contracts" includes certain contracts excluded from the scope of the equivalent prohibition in section 233B of the Insolvency Act 1986.

Life insurance policyholders are also restricted from surrendering their rights under contracts (which typically entitles them to convert those contracts to cash) or switching to a different fund where an insurer enters financial difficulty. This restriction is subject to similar terms (including exemptions) as will apply to terminating supply and financial contracts.

Solvency II Draft SI

Two draft statutory instruments, published on 20 June 2023, will amend the Solvency II Directive in line with HM Treasury's response on the Review of Solvency II.[61] The draft Insurance and Reinsurance Undertakings (Prudential Requirements) Regulations 2023 will amend the onshored Commission Delegated Regulation (EU) 2015/35 to reduce the risk margin. The draft Insurance and Reinsurance Undertakings (Prudential Requirements) (No. 2) Regulations 2023 set out, among other things, the conditions for application of the matching

adjustment, the calculation of the matching adjustment and of the fundamental spread. HM Treasury intends to lay final SIs before Parliament before the end of 2023.

Unauthorised Co-ownership Alternative Investment Funds

The FSM Act grants HM Treasury the power to apply certain rules similar to those under the existing Alternative Investment Fund ("AIF") regime to unauthorised co-ownership AIFs. These rules may relate to: (i) the contracts that the operator of the AIF is permitted to enter into on behalf of the scheme's participants; (ii) the effect of becoming or ceasing to be a participant in an AIF; (iii) limitation of liability of the participants in an AIF; and (iv) the segregation of liability in relation to umbrella co-ownership AIF schemes. The Treasury can apply these rules to unauthorised co-ownership AIFs in general, or those of a specified description. These changes will take effect under regulations that are yet to be made.

Credit Unions

The FSM Act makes changes to the Credit Unions Act 1979 which will apply from 29 August 2023 under the Commencement Regulations. Credit unions may offer hire purchase, conditional sale agreements and insurance distribution services to their members. This is subject to the credit union obtaining FCA approval to carry out the regulated activity. In addition, certain corporate governance changes are made, such as a requirement for credit unions to submit annual accounts to the FCA. The Act also puts on a statutory footing the ability of a credit union to lend to and borrow from other credit unions, even when there is no membership link.

Retail Regulatory Issues

Retail Disclosure

Another priority under the Smart Regulatory Framework is the repeal of the PRIIPs Regulation (and related secondary legislation) and a revised U.K. retail disclosure regime that suits the U.K.'s capital markets and encourages informed retail investor participation in those markets. The FCA will be responsible for designing a new tailored regime. Under FSMA, as amended, the FCA has most of the powers it would need to establish and supervise such a regime. However, with the repeal of the PRIIPs Regulation, two areas will need to be addressed in legislation. These are ensuring unauthorised firms and overseas funds are required to comply with the new disclosure regime. In addition, UCITS will be brought into scope of the new retail disclosure regime.

Before the end of 2023, we can expect HM Treasury to publish a draft statutory instrument and the FCA to consult further on its proposed rules and approach. More clarity should also be coming on the transition from the current disclosure requirements for both packaged products and UCITS. In the meantime, more detail is available in HM Treasury's consultation response.[62]

Future Payments Review

On 11 July 2023, the Future of Payments Review 2023: Call for Input[63] was launched. The Review is considering how payments will be made in the future and seeks feedback on the

most important consumer retail payment journeys, how the U.K. experience compares to other leading countries and whether, other than those already actioned or planned, any other steps can be taken to ensure delivery of world leading payment journeys for U.K. consumers. Consumers includes both individuals and businesses making and receiving retail payments. Responses to the review may be submitted until 1 September 2023. Recommendations for the government, regulators and industry will be published in Autumn 2023.

Mitigating the Risks of Authorised Push Payment ("APP") Scams

The FSM Act introduces a new obligation on the PSR to introduce a requirement for mandatory reimbursement by payment service providers where a payment is executed over the Faster Payments Scheme and the payment was executed subsequent to fraud or dishonesty. This is most likely to apply in situations where APP fraud has occurred. The PSR has a duty to consult on the draft regulatory requirement by 29 October 2023, and to impose such regulatory requirement by 29 February 2024. Following consultation earlier this year, the PSR published a policy statement[64] on 7 June 2023 setting out details on how the requirement will operate. It states that the draft legislative instruments will be published for consultation in Q3 2023 and that the exact date in 2024 that the requirement will apply will be confirmed at this time.

Recently, the Supreme Court rejected an attempt to extend the so-called *Quincecare* duty on banks in such a way as to require them to watch out for and prevent APP fraud. We discuss the decision in our client note "When Push Comes to Shove: UK Supreme Court Confirms that Third-Party Push Payment Fraud is not Covered by *Quincecare* Duty".

Enhancing the Financial Promotions Regime – the Regulatory Gateway

The FSM Act implements the regulatory gateway for the approval by authorised firms of financial promotions of unauthorised firms. Authorised firms are banned from approving financial promotions of unauthorised firms and will need to apply to the FCA to have the prohibition removed in whole or part before they are able to approve financial promotions of unauthorised firms. Firms that apply for authorisation in future will be able to apply for a permission to approve such financial promotions at that time. The FCA is able to apply conditions to a permission, such as restricting the types of financial promotions a firm can approve, and can revoke a firm's permission if a firm does not approve any promotions in a 12-month period or if the FCA believes it would advance one of its operational objectives.

HM Treasury is empowered to make regulations providing for exemptions from the requirement to pass through the regulatory gateway. Under the FSM Act, these powers have applied since 29 June 2023. HM Treasury has indicated that exemptions will be available for authorised firms approving financial promotions of unauthorised companies within their group and for principals approving financial promotions for their appointed representatives for regulated activities, for which the principal has agreed to accept responsibility.

Financial Ombudsman Service

New provisions were added during the legislative process relating the Financial Ombudsman Service ("FOS"). Treasury is empowered from 29 August 2023 to make secondary legislation expanding the scope of those who may be obliged to pay case fees to the FOS. The FOS is a form of cost-free dispute resolution for retail clients of regulated firms. Previously, only the respondent firm could be liable for fees. The changes mean that HM Treasury can allow the

FOS to charge, for example, claims management companies and certain other professional representatives supporting those that bring complaints about financial services firms.

Protecting Retail Access to Cash

The FSM Act protects access to cash by inserting a new Part 8B into FSMA. Firms designated by HM Treasury will be obliged to ensure reasonable access to withdrawal and deposit facilities, such as ATMs, for individuals and reasonable access to deposit facilities for SMEs. As proposed, HM Treasury will be empowered to set geographic baselines for reasonable access to cash withdrawal and deposit facilities across the U.K. Flexibility in adapting the baselines in response to changing needs is preserved as the baselines will be set out in a policy statement following consultation with the FCA. The FCA has been given powers to oversee the designated firms to ensure the reasonable provision of cash access services and will make rules governing designated firms. In addition, the FCA is able to direct and impose requirements on designated firms. The FSM Act provides that these measures will apply from 29 August 2023.

[1] The Financial Services and Markets Act 2023 (Commencement No. 1) Regulations 2023 (S.I. 2023/779).

[2] We discussed the Edinburgh Reforms in our client note, "UK Government Publishes Edinburgh Reforms for Financial Services."

[3] S.I. 2018/698.

[4] Regulation (EU) 2015/760 on European long-term investment funds; the European Long-term Investment Funds Regulations 2015 (S.I. 2015/1882) and Commission Delegated Regulation (EU) 2018/480 of 4 December 2017 supplementing Regulation (EU) 2015/760 with regard to regulatory technical standards on financial derivative instruments solely serving hedging purposes, sufficient length of the life of the European long-term investment funds, assessment criteria for the market for potential buyers and valuation of the assets to be divested, and the types and characteristics of the facilities available to retail investors.

[5] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

[6] Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.

[7] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

[8] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

[9] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

[10] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

[11] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products.

[12] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

[13] Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (S.I. 1999/2979).

[14] Payment Services Regulations 2009 (S.I. 2009/209).

[15] Alternative Investment Fund Managers Regulations 2013 (S.I. 2013/1773).

[16] Bank Recovery and Resolution Order 2014 (S.I. 2014/3329).

[17] HM Treasury, Building a Smarter Financial Services Regulatory Framework for the UK, Policy Statement, 9 December 2022 and HM Treasury, Building a Smarter Financial Services Regulatory Framework for the UK: Delivery Plan, Policy Statement, 11 July 2023.

[18] Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.
[19] Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.
[20] S.I. 2017/699.
[21] Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance.
[22] The Electronic Money, Payment Card Interchange Fee and Payment Services (Amendment) Regulations 2023 (S.I. 2023/790).
[23] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.
[24] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/ EU and Regulation (EU) No 596/2014.
[25] HM Treasury Consultation and call for evidence, "Future financial services regulatory regime for cryptoassets" February 2023.
[26] Draft Public Offers and Admissions to Trading Regulations 2023 and the Public Offers and Admissions to Trading Regulations 2023: Policy Note, 11 July 2023.
[27] This includes a prohibition on the marketing of "speculative illiquid securities" to retail investors (FCA, PS20/15: High-risk investments: Marketing speculative illiquid securities (including speculative mini-bonds) to retail investors, December 2020).
[28] FCA, Admission to trading on a regulated market – Engagement Paper 1, 18 May 2023; FCA, Further issuances of equity on regulated markets – Engagement Paper 2, 18 May 2023; FCA, Protected forward-looking statements – Engagement Paper 3, 18 May 2023; FCA, Non-equity securities – Engagement Paper 4, 18 May 2023; FCA, The public offer platform - Engagement Paper 5, 13 July 2023; FCA, Primary multilateral trading facilities - Engagement Paper 6, 13 July 2023.
[29] HM Treasury Consultation Response, "Short Selling Regulation Review - Government response" July 2023.
[30] HM Treasury Consultation, "Short Selling Regulation Review - sovereign debt and CDS consultation" July 2023.
[31] Joint PRA and FCA Discussion Paper, Operational resilience: Critical third parties to the UK financial sector (DP 3/22 and DP 22/3), 21 July 2022.
[32] PRA consultation paper, PRA statement on the review of rules, (CP 11/23), 30 June 2023.
[33] FCA corporate document, Rule Review Framework, 14 July 2023.
[34] FCA Statement, Secondary international competitiveness, 14 July 2023.
and growth objective
[35] See our client note, "The UK's Financial Services Bill – Proposed Amendments Towards Enhanced Accountability For Financial Regulators", January 26, 2023.
[36] FCA, Complaints Scheme: our approach to remedies, 19 June 2020.
[37] See the FRCC's decision here: The Complaints Commissioner Final Report LCF.
[38] See the FCA's Complaints Scheme, effective from 1 November 2023.
[39] See HM Treasury consultation, Wholesale Markets Review, July 2021 and HM Treasury consultation response, Wholesale Markets Review, March 2022.
[40] Press release, "Chancellor's Mansion House Reforms to boost typical pension by over £1,000 a year", HM Treasury, July 10, 2023.
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