Regulatory insights

February 2023

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Cyprus updates

Cyprus Securities and Exchange Commission

Guidance on Liquidity Risk Management ('LRM')

CySEC issued on 10 February 2023 circular C548 to provide Regulated Entities with guidance aimed at assisting them to ensure compliance with their LRM legal obligations.

The above follows on the results of the 2020 Common Supervisory Action ('CSA') on UCITS liquidity risk management launched by ESMA.

More information can be found here.

Deprioritisation of supervisory actions on the obligation for investment firms to publish RTS 27 reports after 28 February 2023 in light of the ongoing legislative procedure on the MiFID II/MiFIR review.

CySEC issued on 2 February 2023 circular C549 to inform regulated entities on its supervisory actions regarding the RTS 27 reporting obligation. CySEC adopts ESMA's approach on the relevant matter as stated in a public statement dated 14 December 2022.

> From 1 March 2023 until the forthcoming legislative amendment to Article 27(3) of MiFID II applies, ESMA expects NCAs not to prioritise supervisory actions towards execution venues relating to the periodic reporting obligation on them to publish the RTS 27 reports.

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European updates

Asset Management

New ELTIF 2.0 regulation

The European Parliament voted in favor of amending the European Long-Term Investment Funds (ELTIF) Regulation, following the European Commission’s proposal in November 2021. The revised regime has the potential to become an attractive “go-to” fund structure for long-term investments, with particularly beneficial improvements for retail investors.

The changes have made the ELTIF fund structure more attractive to asset managers and investors alike, including:

- A broader scope of eligible assets, including a simplified definition of “real assets”, an increased market capitalisation threshold, and the possibility to invest in FinTechs, STS securitisations and green bonds;
- Flexible fund rules with an increased pocket for liquid investments, more flexible risk diversification requirements, the ability to invest in fund-of-funds and master-feeder structures, as well as utilising increased leverage; and
- Improved access and safer conditions for retail investors, including removal of the previous €10,000 entry ticket, removal of the minimum net worth requirement, and harmonisation of the distribution regime through alignment of the ELTIF suitability test with MiFID II.

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The revised ELTIF Regulation is expected to be published in the Official Journal of the EU in March 2023 and enter into application in Q1 2024. Existing ELTIFs launched under the current regime will continue to be deemed compliant for five years following the entry into application of ELTIF 2.0. Any ELTIFs authorised under the current regime, but wishing to take advantage of the new regime can do so provided that they notify their NCA.

“The changes to the current ELTIF framework are an excellent and necessary step forward that will assist ELTIF in becoming a complementary source of financing for the European real economy and notably, accessing the almost untapped retail market for longer-term real assets investments.”

Vice-Chair of the EFAMA Fund Regulation Standing Committee

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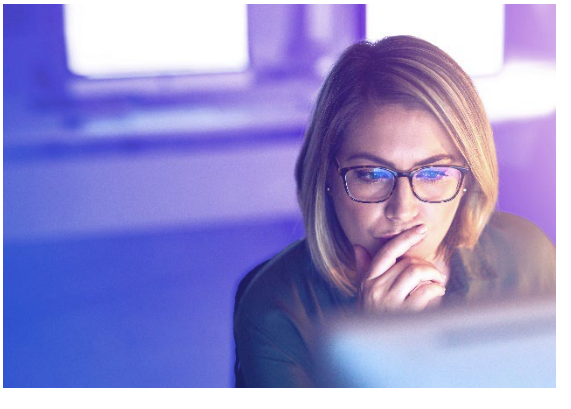
EFAMA latest statistics

EFAMA published on 21 February 2023 its latest monthly Investment Fund Industry Fact Sheet, which provides net sales data on UCITS and AIFs for December 2022 at European level and by country of fund domiciliation. A first overview and analysis of the net sales data of UCITS and AIFs over the full year 2022 is also included.

The main developments in 2022 can be summarised as follows:

- UCITS suffered net outflows of EUR 175bn in 2022, for the first time since 2011.
- Equity funds recorded net outflows of EUR 72bn. These net outflows represented 1.2% of the value of equity fund assets at the end of 2021. The slowdown in economic growth triggered by Russia's war against Ukraine and the tightening of monetary policy undermined investor confidence and led to sharp falls in stock markets and net outflows from equity funds. Considering the significant worsening of the economic, financial and geopolitical environment, these outflows can be viewed as moderate.
- Bond funds recorded their worst year since 2008. They suffered net outflows of EUR 137bn, or about 4% of their net asset values at the start of 2022. Higher interest rates led to capital losses for bondholders, while the expectation that interest rates would continue to increase for some time deterred investors for most of the year.
- Multi-assets funds were the most popular type of long-term UCITS. They attracted EUR 14bn in new money. The greater diversification across asset classes gave these funds a competitive advantage in a down year for stock and fixed-income markets.
- Despite a challenging year, money market funds ended the year with positive net sales of EUR 14bn.
- 2022 was a good year for exchange-traded funds (ETFs). Net flows remained positive (EUR 85bn) thanks to ETF's low costs and trading flexibility.
- The demand for SFDR Article 9 funds remained robust. These funds, which have an explicit sustainability objective, attracted EUR 26bn of net new money. This outcome is even more noticeable given the fact that many fund managers reclassified their Article 9 funds to Article 8 in the second half of the year as a result of the clarification provided by ESMA in June 2022 regarding the SFDR regulatory technical standards for Article 9 funds.
- Net sales of AIFs turned negative for the first time ever (EUR 101bn). This development can be explained by the decision taken by several pension funds in the Netherlands, and to a lesser extent in Denmark, to stop managing their assets within AIF wrappers and make more use of segregated mandates due to the new IFR/IFD prudential rules. Net sales of AIFs in other European countries remained positive and totaled EUR 112bn.



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ECON Committee publishes report on AIFMD2

The ECON has published on 2 February 2023 its report on the European Commission's proposal for a directive amending the AIFMD and UCITS Directive (AIFMD2).

The report sets out a draft legislative resolution setting out the ECON Committee's proposed amendments for adoption by the EU Parliament at first reading, which build on the amendments published in a May 2022 draft report relating to:

- delegation and supervisory reporting;
- loan origination funds;
- liquidity management tools (LMTs);
- depository services; and
- transparency, data collection and disclosure.

In a joint declaration published in November 2022, AIFMD2 was established by the three EU institutions as one of their legislative priorities.

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ESMA issues its first opinion on the draft European Sustainability Reporting Standards

ESMA has issued on 26 January 2023 an opinion on the first set of draft European Sustainability Reporting Standards (ESRS Set 1) developed by the European Financial Reporting Advisory Group (EFRAG). ESMA finds that ESRS Set 1 broadly meets the objective of being conducive to investor protection and of not undermining financial stability.

The EC will now consider ESMA's opinion alongside opinions submitted by the EBA, EIOPA and other public bodies and adopt ESRS Set 1 into delegated acts by 30 June 2023.

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European Council proposal for a Directive on financial services contracts concluded at a distance

On 16 February 2023, the Council of the EU published a compromise proposal (dated 18 January 2023) on the proposed Directive on financial services contracts concluded at a distance. The proposed Directive amends Directive 2002/65/EC (the "Distance Marketing of Financial Services Directive") to strengthen consumer rights and foster the crossborder provision of financial services.

The rationale for the proposed Directive is that the market on financial services contracts concluded at a distance has significantly evolved since the Distance Marketing of Financial Services Directive with the overall digitalisation of the sector and the new types of financial services that have been developed. These developments have been further enhanced by the impact of COVID 19, which greatly contributed to an increase in online transactions.

This is the fifth Presidency compromise proposal on the proposed Directive. The fourth Presidency compromise proposal was published on 31 January 2023 (dated 8 December 2022).

European Commission call for advice to EBA and ESMA to evaluate IFR and IFD prudential framework

On 20 February 2023, the European Commission published a call for advice to the European Banking Authority ("EBA") and European Securities and Markets Authority ("ESMA") to provide an evaluation on the prudential framework for investment firms that has applied since June 2021.

In accordance with Article 60 of Regulation 2019/2033 (EU) ("IFR") and Article 66 of Directive 2019/2034 (EU) ("IFD") the EC is required to submit, by 26 June 2024, two reports to the European Parliament and the Council on the prudential framework for investment firms. In preparing these reports, the EC is required to consult with the EBA and ESMA.

The EC has acknowledged that the prudential framework for investment firms only entered into force relatively recently and that this may impact the ability of the EBA and ESMA to collect the necessary evidence on the topics in this Call for Advice. Therefore the EC is requesting the EBA and ESMA to evaluate these topics "to the extent currently possible" and "identify those topics which are better suited for a future review when the prudential framework has been in place longer".

The EBA and ESMA are also encouraged to make use of, and build on, analyses yet conducted (e.g. ESG risks, digitalisation and crypto assets).

The EC has requested generally that the assessment includes:

- information about the structure of the market, distinguishing between investment firms' categories and business models;
- the impact on the capital requirements of investment firms resulting from any change proposed to the current legislation; and
- an estimate of the impact of any recommendation both in terms of changes to the own funds' requirements and the operational and administrative costs incurred by investment firms.

The EC has requested that the assessment specifically considers:

- the categorisation of investment firms;
- interactions with Regulation 575/2013 ("CRR") and Directive 2013/36/EU ("CRD IV");
- ESG Risks;
- whether changes to the IFR/IFD are warranted due to the emergence of new market players/transformations of businesses as a result of digitalisation, the impact of crypto assets and the risks resulting from the interactions between investment firms and other financial activities; and
- specific considerations on commodity and emission allowance dealers and on energy firms.

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The EBA and ESMA are also requested to include other issues or inconsistencies that competent authorities in the EU may have identified during the implementation of the IFR/IFD framework and any suggestions on how to rectify these issues.
The EBA and ESMA are requested to deliver their joint report to the EC by 31 May 2024.

ESMA and NCAs to look at marketing of financial products

ESMA is launching a common supervisory action (CSA) with the national competent authorities (NCAs) on the application of MiFID II disclosure rules in relation to marketing communications across the EU. As part of the CSA, NCAs will review whether marketing communications are fair, clear and non-misleading, and how firms select their target audience, especially in the case of riskier and more complex investment products. The CSA will also review marketing and advertising through distribution channels including apps, websites and social media. Finally, the CSA will also be an opportunity to gather information on possible greenwashing. The overall aim of the initiative is to ensure consistent implementation of EU rules and improve investor protection.

The CSA will be conducted over the course of 2023.

ESMA first TRV report for 2023

ESMA publishes the first Trends, Risks and Vulnerabilities (TRV) Report of 2023. Overall, risks in ESMA's remit remain high, and investors should be prepared for further market corrections. The main finding are:

Overall risk assessment: Contagion and operational risks are considered very high, as are liquidity and market risks. Credit risk stays high and is expected to rise, reflecting the growing concerns over public and corporate indebtedness.

Risks remain very high in securities markets and for asset management. Risks to infrastructures and to consumers both remain high, though now with a worsening outlook, while environmental risks remain elevated.

The Market environment: The tightening of financial conditions globally has weighed on economic activity, while inflation remains very high. Volatility in energy markets stayed elevated despite a general decline in prices. Structural vulnerabilities expose markets and participants to the risk that shocks to markets could be amplified by liquidity supply and demand imbalances.

Securities markets: Equity prices were volatile in 2H22 with markets partially recovering 3Q22 losses based on news flow around relatively stable inflation and positive corporate earnings.

Asset management: The EU fund sector has seen outflows and low performance across most fund types in 2H22, as assets under management experienced their sharpest decline since the global financial crisis. Maturity mismatches in Commercial Real Estate Funds persist, and the impact of the UK Gilt market turmoil on leveraged Liability-Driven Investment Funds in 2H22 confirmed existing concerns over fund liquidity risk management and excessive leverage, as well as contagion risks given strong systemic interconnections.

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Consumers: Investor sentiment remains weak, against the backdrop of economic uncertainty. Inflation acts as a drag on real investment returns and contributes to falling household savings.

Infrastructures and services: Central clearing volumes grew further, as margins collected by EU CCPs for interest rate and commodity derivatives rose with rises in prices and volatility in underlying instruments, while some migration from ETD to OTC energy derivatives was observed.

Market-based finance: Capital market financing decreased sharply in 2022, turning negative for the first time since the Covid-19 related market stress in early 2020. The drop in activity is linked to high investor uncertainty, tighter credit standards for firms, high corporate debt levels and a rapid increase in the overall cost of external financing in the euro area.
Sustainable finance: Net-zero pledges have come under growing scrutiny, with the energy crisis jeopardising decarbonisation objectives. More broadly, the focus on greenwashing has increased while investors increasingly appear to differentiate between products based on their sustainability credentials, as reflected in steady net flows into SFDR Article 9 funds. Despite this, ESG markets continued to grow, with this trend showing resilience to broader market developments.

Crypto-assets and financial innovation: Crypto-asset valuations have now fallen by almost 70% year-on-year, driven by macro-economic factors and several high-level collapses in 2022. The recent failure of FTX, formerly one of the largest centralised crypto exchanges, triggered some large market corrections across crypto-assets. Contagion within the crypto sector has been substantial, reflected in further price drops of key crypto instruments and knock-on bankruptcies among service providers. Given low exposures by EU market participants, material spill-over effects of the crypto turmoil into the EU finance sector and the real economy have not been registered so far.

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ESMA TRV Risk Analysis on artificial intelligence in EU securities markets

ESMA publishes an article on 1 February 2023 on the use of artificial intelligence (AI) in finance an area which is under increasing scrutiny from regulators and supervisors interested in examining its development and the related potential risks. The article contributes by providing an overview of AI use cases across securities markets in the EU and assessing the degree of adoption of AI-based tools.

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Anti-Money Laundering and list of non-cooperative jurisdictions

EU Council updates list of non-cooperative jurisdictions for tax purposes

The EU Council has on 14 February 2023 adopted a revised list of non-cooperative jurisdictions for tax purposes.
The following jurisdictions have been added to the list:
• the Marshall Islands, due to concerns that it has a zero or nominal rate of corporate income tax attracting profits without real economic activity and lacking in the enforcement of economic substance requirements;
• the British Virgin Islands, as they were found not to be sufficiently in compliance with the OECD standard on exchange of information on request;
• Costa Rica, due to not fulfilling its commitment to abolish or amend the harmful aspects of its foreign source income exemption regime; and
• Russia, due to not fulfilling its commitment to address the harmful aspects of a special regime for international holding companies and dialogue with Russia on matters related to taxation came to a standstill following the Russian aggression against Ukraine.

The following 16 jurisdictions are now on the list of non-cooperative jurisdictions (Annex I): American Samoa, Anguilla, The Bahamas, the British Virgin Islands, Costa Rica, Fiji, Guam, the Marshall Islands, Palau, Panama, Russia, Samoa, Trinidad and Tobago, Turks and Caicos Islands, the US Virgin Islands and Vanuatu.

The Council has also approved the state of play document (Annex II), which identifies cooperative jurisdictions which have made further improvements to their tax policies or related cooperation.

The next revision of the list is scheduled for October 2023.
More information can be found here.

Payment Institutions, e-money institutions and banking

EBA seeks input from credit institutions on green loans and mortgages

EBA has launched an industry survey to receive input from credit institutions on their green loans and mortgages as well as market practices related to these loans. The purpose of the survey is to collect both quantitative and qualitative information the EBA can use to advise the EC. The work is part of the EC's strategy for financing transition to a sustainable economy. Institutions wishing to take part in the survey should contact the national competent authority in their EU/EEA country to receive the survey templates as well as information on the process.

The deadline for responding to the survey is 7 April 2023.

Revised guidelines for calculating contributions to deposit guarantee schemes EBA has published on 21st February 2023 its final report on Guidelines on methods for calculating contributions to deposit guarantee schemes (DGSs) under the Deposit Guarantee Schemes Directive (2014/49/EU) (DGSD) (the revised Guidelines). The revised Guidelines will repeal and replace the EBA's previous Guidelines on the topic (EBA/GL/2015/10) (the original Guidelines), which were published in May 2015. This follows the EBA's Consultation Paper on the revised Guidelines published in July 2022.

The EBA has decided to go ahead with the amendments in the earlier consultation and to provide additional guidance on the application of a stock-based approach to calculating contributions (which takes into account past contributions of member institutions). It has also refined the current requirement on the forward-looking approach to raising contributions on the delineation and reporting of available financial means of DGSs.

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ECB climate-related statistical indicators

ECB publishes new set of climate-related statistical indicators

The ECB has published new climate-related statistical indicators, and a detailed technical annex, in a bid to narrow the gap around availability and quality of climate-related data.

The indicators cover three main areas:

- **Sustainable finance indicators**: these aim to provide an overview of the issuance and holding of debt instruments with sustainability characteristics by residents in the euro area, offer market transparency and contribute to the design and implementation of ECB monetary policy.
- **Carbon emissions indicators**: these aim to provide information on the carbon intensity of financial institutions' securities and loan portfolios and help assess the financial sector's role in financing the transition to net-zero.
- **Physical risk indicators** of loan and security portfolios: these aim to assess risks from the impact of climate change-induced natural hazards, such as floods and wildfires, on the performance of loans, bonds and equities.

The ECB classifies the new indicators as either '**experimental**', meaning they do not comply with all of the quality requirements of official ECB statistics, or '**analytical**', meaning the data may have significant limitations. They are a work in progress, and although firms may begin using them now, they are warned to do so with caution. The ECB will work with national central banks to improve its methodology and broaden the data sources used in this work.

More information can be found here.

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Glossary

AIF Alternative Investment Fund (EU)

AIFMD Directive 2011/61/EU on Alternative Investment Fund Managers

AIFMs Alternative Investment Fund Managers

AML Anti-Money Laundering

CASP Crypto Asset Service Providers

CySEC Cyprus Securities and Exchange Commission

CP Consultation Paper

DLT Distributed Ledger Technology

DORA Digital Operational Resilience Act

EBA European Banking Authority

EC European Commission

ECB European Central Bank

ESG Environmental, social, and governance

EMIR European Market Infrastructure Regulation

ESAs European Supervisory Authorities (EBA, EIOPA and ESMA)

ESMA European Securities and Markets Authority

EIOPA European Insurance & Occupational Pensions Authority

EU European Union

ICT Information and Communications Technology

KID Key information Document (under UCITS Directive)

KIID Key Investor Information Document (under PRIIPS)

MiCA Markets In Crypto-Assets regulation

MiFID Markets in Financial Instruments Directive

NCA National Competent Authority

PRIIPS Package Retail and Insurance-based products

RTS Regulatory Technical Standards

SME Small and Medium-sized enterprises

SFDR Sustainable Finance Disclosure Directive

OECD Organisation for Economic Co-operation and Development

UCITS Directive directive 2009/65/EC on Undertakings for Collective investments in Transferable Securities

UCITS Undertakings for Collective investments in Transferable Securities (EU)

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