What are the top priorities of 2021
Regulatory agenda

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A snapshot of the regulatory agenda at your fingertips for the EU and Luxembourg

The 2021 version of the Deloitte regulatory poster outlines the latest regulatory trends and describes the associated challenges for market participants. Topics covered range from new rules on investments, capital requirements, ESG, and sustainability through to provisions on digital and prudential regulations.

This interactive document will help you focus on the changes and updates slated for 2021, a year marking the start of the post-Brexit era. This should now enable the European Commission to refocus its regulatory program and transform into new measures the different strategies such as digital, AML, capital market, and post-trade regulation, alongside its review of the AIFM Directive.

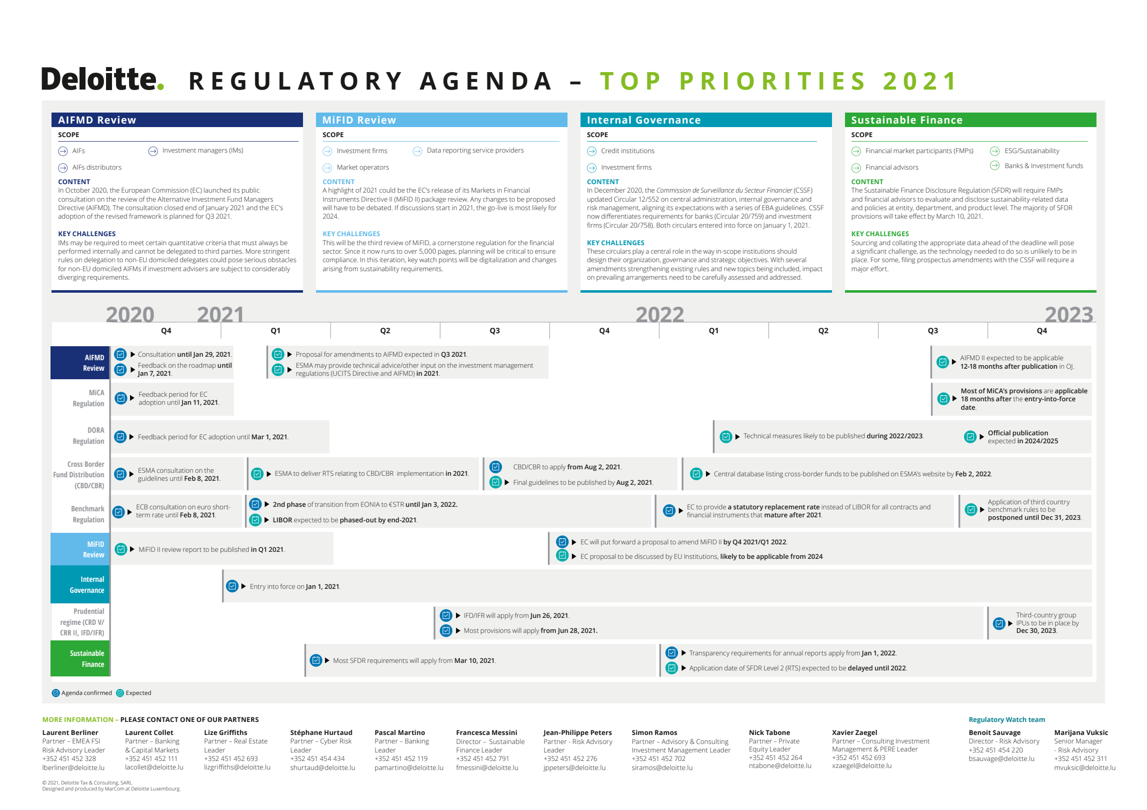
Anticipating regulatory change is a worthwhile if costly investment as it may mean avoiding fines or sanctions. At the start of 2020, the three European Supervisory Authorities (EBA, ESMA and EIOPA) all received new powers which combined with the new standards, means we are heading towards new levels under the aegis of the single supervisory rule book. Based on different sources, fines average around EUR 2 billion a year, and in the case of Luxembourg reached EUR 5 million in 2020, thereby making it all the more urgent that entities address the issues raised by regulatory change.

The Deloitte regulatory poster combines a timeline highlighting essential regulations as announced, with a dedicated section to shed some light on the critical topics as chosen by our experts. The poster is aimed at helping financial institutions prepare for upcoming regulatory changes and identify their priorities whilst highlights common trends that may provide an opportunity to leverage potential synergies across different areas.

Stay tuned!

Via our overview of regulatory trends, we believe the best way to address regulatory change is to embrace new regulations as a natural progression. Think of it as evolution rather than revolution. Nothing remains the same forever, and regulations will always be subject to change as we develop and move forward.

We hope our regulatory poster and accompanying explanations will provide you with an introduction to navigating forthcoming regulatory change, and invite you to explore with your favorite Deloitte experts on how your activities will be impacted, so you can be ready to face the new regulatory future.



AIFMD Review

SCOPE

- Alternative Investment Funds (AIFs)
- Collective investment fund managers
- AIFs distributors
- Investment firms
- Depositories

CONTENT

In August 2020, the European Securities and Markets Authority (ESMA) sent a letter to the European Commission proposing a review of the Alternative Investment Fund Managers Directive (AIFMD). The European Commission subsequently launched a public consultation on the review, in October 2020 with the consultation closing just before the publication of this poster.

While the AIFMD regulatory architecture is generally regarded as robust and effective, the industry believes it is missing a number of important regulatory elements. For example, there is no passporting option for sub-threshold AIFMs and depositories, meaning that these entities can only operate within their home member state without full access to the benefits of the single market. There are also no common rules for loan originating AIFs, and AIFMs managing such funds are subject to varying rules in the different member states.

Another issue impeding the creation of a single AIF market is retail investor access, which remains subject to national rules. Furthermore, there is an uneven playing field with other financial intermediaries providing identical services, for example, MiFID firms and UCITS providing individual portfolio management.

From a macro-prudential perspective, the European Commission will also assess potential enhancements to ESMA's supervisory powers, particularly in relation to third country AIFMs. It will be further examined whether the intervention powers and toolkit available to the supervisors are sufficient to ensure systemic financial stability. An international approach to leverage reporting developed by IOSCO could improve data comparability. More granular information on certain asset classes, such as leveraged loans and collateralized loan obligations, is expected to be required for the purpose of effective macro-prudential oversight.

Finally, additional definitions and rules are expected to be included in the framework to facilitate improved regulatory compliance concerning, for example, tri-party collateral management, prime broker activities, own-account investment or delegation of AIFM functions to third parties.

European Commission adoption of the revised framework is planned for Q3 2021.

KEY CHALLENGES

ESMA's review of the AIFMD is largely focused on the issue of delegation. In this regard, investment managers could face requirements to meet certain quantitative criteria (in addition to, or instead of, the AIFMD's qualitative criteria) or be presented with a list of core or critical functions that must always be performed internally and which cannot be delegated to third parties.

Furthermore—clearly with Brexit in mind—ESMA is considering whether to propose more stringent requirements for delegation to non-EU delegates. ESMA is of the view that non-EU delegates should be "subject to the regulatory standards set out in the AIFMD [...] irrespective of the regulatory license or location of the delegate." If the European Commission decides to take this route, it could pose serious obstacles for non-EU domiciled AIFMs, where investment advisers are subject to substantially different requirements.

What are the top priorities of 2021 Regulatory agenda

MiCA Regulation

SCOPE

- Issuers of crypto-assets
- Crypto-asset service providers
- Utility tokens
- Asset-referenced tokens
- E-money tokens

CONTENT

On September 24, 2020, the European Commission published its digital finance strategy, including a comprehensive framework for facilitating distributed ledger technology (DLT) and crypto-assets in the financial sector (MiCA Regulation). The proposed framework for crypto-assets should allow for innovation that preserves financial stability and protects investors. Crypto-assets are digital representations of values or rights, which are transferred and stored electronically. They can be used as an access key to a service, may facilitate payments, or could be designed as financial instruments. The European Commission differentiates between those crypto-assets already governed by EU legislation, and others. The former will remain subject to existing legislation. The European Commission is also proposing a Pilot Regime for market infrastructure institutions that would be interested to experiment with the issuance, register, trade and settlement of transactions in less liquid financial instruments (i.e bonds) in crypto-asset form under a common and unique DLT Market Trading Facility (MTF) platform.

For previously unregulated crypto-assets, including 'stablecoins', the European Commission proposes a bespoke regime. The proposed regulation sets out strict requirements for issuers of crypto-assets in Europe and crypto-asset service providers wishing to apply for an authorization to provide their services in the single market. Safeguards include capital requirements, custody of assets, a mandatory complaint handling procedure available to investors, and investor rights vis-à-vis the issuer. Issuers of significant asset-backed crypto-assets would be subject to more stringent capital requirements, liquidity management, and interoperability requirements. European Commission adoption of the crypto framework is planned for Q1 2021.

KEY CHALLENGES

Digitalization of Assets under MiCA will allow market participants to develop and deploy new ways to make financial products available in a more resilient and secure manner across the EU under one regulatory roof for products/services so that these products could be issued today under the current regulatory framework and in the future under the new digital assets regime under MICA. Changes would apply not only in distribution, custody services and in many aspects of the execution value chain, from issuance to asset servicing, but also to indirect services like collateral management.

To fully leverage DLT and security token opportunities, it will be essential to understand and implement DLT not just as a new type of "database" but rather as a new way of organizing the security value chain from issuance to custody. This is clearly one of the main challenges the industry will face, as it will have to break away from the sequential centralized value chain and embrace a distributed leger model where participants can access the same information simultaneously.

DORA Regulation

SCOPE

- Banks
- Clearing houses
- Fintechs
- Stock exchanges
- Cloud-computing service providers

CONTENT

The Digital Operational Resilience Act (DORA) was proposed by the European Commission on September 24, 2020, as part of its digital financial package, which includes a strategy paper for financial activities with long-term priorities. It anticipates—but does not confirm—the potential use of artificial intelligence, quantum computing, and other technologies.

DORA aims at including and defining the roles of service providers and users of information and communication technologies to make them as efficient and resilient as possible to support the digital financial strategy. Thus, DORA will bring technology providers into the regulatory scope. It will also give European Supervisory Authorities enhanced regulatory powers and proposes to ensure efficiency of the systems and networks through mandatory penetration tests and harmonization of ICT risk management rules or classification of incidents. Concretely DORA should help provide the technical conditions needed to make the digital financial strategy work.

From a pragmatic point of view, DORA focuses on the efficiency and resilience of IT systems and technologies by requiring firms to be prepared to withstand potential hits or other cyber attacks on network infrastructures. Accordingly, the regulation defines a list of situations and entities that are part of these essential networks, and which therefore need to anticipate (via governance structures and stress tests), prevent (using appropriate technologies) and report (to authorities and other stakeholders) potential or actual events.

The proposed DORA regulation, together with MiCA and the sandbox regime, will be discussed by the European institutions in 2021, with a definitive text accompanied by technical measures likely to be available in 2022/23, and entry into force—depending on the official publication date—in 2024/25.

KEY CHALLENGES

For many institutions, DORA already contains the future architecture of the technical digital requirements needed to support the widespread arrival of technologies such as blockchain, digital assets, and the increased use of data. Concretely DORA will address:

- Critical ICT third party providers
- Digital operational resilience testing
- ICT risk management rules
- ICT incident classification and reporting

We can now look to anticipate the future needs of digital financial services, focusing largely on making systems robust and able to handle massive amounts of data in instantaneous or at least near real-time. This will mean—especially post Covid-19—managing complex networks of clients, suppliers, and employees working from various locations, thereby creating significant challenges or potential weaknesses in infrastructure networks.

Cross-Border Fund Distribution

SCOPE

- Investment funds managers
- UCITS
- AIFs
- EuSEFs
- EuVECAs

CONTENT

The EU Regulation and Directive on cross-border fund distribution is aimed at facilitating the cross-border marketing of UCITS and AIFs, including EuSEFs and EuVECAs, throughout the EU by removing existing barriers and enhancing investor protection.

The Regulation improves transparency by aligning national marketing requirements and regulatory fees. It introduces more consistency in the way these regulatory fees are determined. It also harmonizes the process and requirements for the verification of marketing material by national supervisory authorities. The Regulation's requirements for marketing communications and the amendment of the EuVECA and EuSEF provisions enter into force on August 1, 2021 (August 2, 2021 for certain articles).

The Directive harmonizes the conditions under which investment funds may exit a national market and creates the possibility for asset managers to stop marketing an investment fund in defined cases in one or several host member states. It also allows European asset managers to test the appetite of potential professional investors for new investment strategies through pre-marketing activities.

The Directive must be transposed into national law by August 2, 2021, and member states are required to apply the new provisions from the same date.

KEY CHALLENGES

In the scope of the AIFMD framework, any subscription made by professional investors within 18 months of an AIFM having begun pre-marketing shall be deemed to be the result of marketing, requiring a marketing notification to be submitted to the relevant host state supervisory authorities. As a result, AIFMs might expect the new pre-marketing regime to impact their reverse solicitation approach, effectively restricting its use.

Nevertheless, in its broad review of the AIFMD framework, ESMA specifically underlined the importance of clarifying the notion of reverse solicitation, which is currently subject to divergent practices and interpretation at national level. We may therefore expect greater clarity to be provided in terms of the reverse solicitation model going forward.

Benchmark Regulation

SCOPE

- Banks
- Investment funds
- Central counterparties (CCPs)
- Benchmark administrators
- Trade repositories

CONTENT

On January 1, 2018, the Benchmark Regulation (BMR), came into force. Since then, EU regulators such as the European Commission (EC) and European Central Bank (ECB) have embarked on a number of initiatives to ensure the accuracy and integrity of critical benchmarks, including LIBOR, EURIBOR, and EONIA.

The EC's July 24, 2020 proposal to amend the BMR was linked to the announcement from the UK's Financial Conduct Authority (the supervisor of LIBOR) that it would stop supporting this benchmark at the end of 2021 and expected its cessation shortly thereafter. An agreement was reached by the European Parliament and the Council on November 30, 2020 "to empower the EC to designate a replacement benchmark that covers all references to a widely used reference rate that is phased out." Moreover, "the statutory replacement rate will only be available for financial contracts that reference, for example LIBOR, at the time this benchmark ceases to be published." This rate would take the place of LIBOR in all contracts and financial instruments that mature after 2021.

The agreements also postpone the entry into force of the rules on third country benchmarks until December 31, 2023, with the possibility of a further extension. This means that EU benchmark users will continue to have access to these benchmarks.

Many contracts in financial markets also make reference to EURIBOR. If this benchmark rate ceases to exist, the absence of a fallback rate would expose counterparties to substantial risk. On November 23, 2020, the ECB launched two public consultations to consider the role of the ECB's euro short-term rate (€STR) in establishing resilient fallback provisions concerning trigger events and the most likely fallback rates. The consultations ran until January 15, 2021.

KEY CHALLENGES

According to the EC's proposal, the statutory replacement rate would only apply to contracts concluded by supervised entities, such as banks, investment firms or asset managers. Therefore, this rate would not apply to contracts that do not involve supervised entities. Given that member states will have to legislate to extend the scope of the harmonized statutory replacement rate to also cover non-supervised entities who should start preparing for any developments from national supervisory authorities.

Market participants have also raised concerns regarding the visibility on which rates would be in or out of scope and the territorial scope of the powers, given the complexity of conflict of laws rules in UK and US, which will require further clarification from the EC.

As for the application of €STR-based EURIBOR fallback rates and the transition of EONIA to €STR—despite the scheduled final publication date of January 3, 2022—many market participants continue to refer to EONIA in their derivatives trading. If the proposed fallback provisions are activated, the market would have to rely extensively on €STR. A lack of knowledge and experience in using this rate may then hamper market functioning.

MiFID Review

SCOPE

- Investment firms
- Data reporting service providers
- Market operators

CONTENT

The European Commission's highly anticipated release of the MiFID II package (Directive and Regulation) review is expected at the end of Q1 2021 and is slated as the one to watch in 2021. To assess the possible content of the review, we have monitored indications from a number of sources, including the consultation that took place in 2020.

What is expected, is a digitalization of MiFID (already under way via the Capital Market Recovery Package) and the creation of a new investor category that might be called "super retail investors", aimed at facilitating access to investment ideas for private clients with sufficient investing capital. We also anticipate some rewriting of third country rules to accommodate the UK's new status and the alignment of relationships with other countries on firmer and longer established ground.

In addition, there are likely to be some changes in the inducement regimes that further strengthen the regime, aiming at some day full prohibition, regardless of the direction of travel. Several topics of concern have been identified including the creation of an EU-wide consolidated tape for equity instruments; under this mechanism, market participants would access a single place for market prices at EU level and thereby identify a single reference price for each instrument.

Another concern is that negotiation time under MiFID II may be affected by the inclusion of custody under the core services of the MiFID umbrella, meaning new obligations for custodians, which would then have to apply all MiFID provisions to their clients. A third concern is the potential inclusion of foreign exchange (FX) spot contracts, which would imply the application of profiles, best execution, and reporting to spot currency transactions.

Any proposed changes will need to be debated and final provision will be subject to a transition period. If the discussions start in 2021, the changes will likely enter force in 2024.

KEY CHALLENGES

This will be the third review of MiFID, a cornerstone regulation for the financial sector, running to over 5,000 pages. As such, its myriad details and requirements will need to be analyzed and prepared for well in advance of application.

In this third iteration, key watch points will be digitalization and changes required in response to sustainability requirements. The main task therefore for 2021 will be to keep a close eye on developments at EU institution level and prepare for the possible inclusion of FX spot contracts under the MiFID regime.

Prudential regime (CRD V/CRR II, IFD/IFR)

SCOPE

- Financial holding companies
- Credit Institutions
- Investment firms

CONTENT

On June 7, 2019, the amended Capital Requirements Directive (CRD V) and Capital Requirements Regulation (CRR II) were published in the Official Journal of the European Union, as part of the European Union's Risk Reduction Measures (RRM). The package built upon the existing European prudential framework set out in CRD IV/CRR. In addition to achieving alignment with the revised international standards of the Basel Committee on Banking Supervision, these new rules aimed at improving the capacity of the banking and financial sector to withstand potential shocks.

The CRR II and CRD V amendments included the Basel III reforms, these being an overhaul of the market risk regime, new capital rules for derivatives and securities financing transactions, a binding leverage ratio and supplemental leverage requirement for global systemically important banks (G-SIBs), a net stable funding liquidity ratio (NSFR), and rules on total loss-absorbing capacity (TLAC) for G-SIBs.

In addition to the Basel III-based prudential reforms, the measures contained a number of further changes, including a new authorization and supervision regime for financial holding companies, a new requirement for third country banking groups with significant activity in the EU to establish an EU intermediate parent undertaking (IPU), amendments to Pillar 2 capital rules, amendments to large exposure rules, new remuneration requirements, and proportionality requirements.

Some aspects of the regulations entered force on June 27, 2019. CRR II includes different implementation timeframes, with both fast-track and transitional provisions, most of which will be applicable from June 28, 2021. CRD V transposition was required by December 28, 2020, although it includes some transitional provisions such as the IPU requirement, which must be in place for in-scope third-country groups by December 30, 2023.

KEY CHALLENGES

These reforms will have a significant impact on banks, including an increase in capital requirements, especially for those with substantial trading books and derivatives operations. Banks should expect fundamental consequences for the development of their strategies and business models, particularly following the introduction of new rules on the calculation of risk-weighted assets, and therefore, capital ratios.

The prudential regime package includes a number of standards that may have implications for firms' internal processes, ranging from remuneration standards to environmental, social and governance criteria. Compliance with these will result in additional strategic and operational challenges for firms.

Furthermore, before the European Union's Risk Reduction Measures can be fully implemented, several more years of secondary rule-making lie ahead. Firms should remain vigilant for further regulatory developments, and ensure their implementation programs are sufficiently flexible to accommodate future changes in credit, operational, and market risk.

Sustainable Finance

SCOPE

- Financial market participants (FMPs)
- Financial advisors
- Investment funds
- ESG/sustainability
- Banks
- Insurance

CONTENT

In terms of adapting to recent regulatory changes, the most pressing needs stem from the Sustainable Finance Disclosure Regulation (SFDR), which will require Financial Market Participants (FMPs) and financial advisors to evaluate and disclose sustainability-related data and policies at entity, service, and product level. This is to prevent greenwashing and ensure a systematic, transparent, and comparable approach to sustainability within financial markets.

Although FMPs are working against the clock to be ready in time to meet the requirements of the “sustainable finance regulatory framework”, some players are actively negotiating with supervisors and regulators to defer the application of the Regulatory Technical Standards (RTS) for sustainability-related disclosures. Many financial debates during the past few months have highlighted serious concerns that the SFDR’s target population may not be adequately prepared to address these changes. Some of the current timelines are rather tight or even unachievable; the majority of SFDR provisions are supposed to be effective from March 10, 2021.

Another major obstacle is the lack of definitive guidelines. The European Supervisory Authorities had until the end of 2020 to submit precise templates, meaning that, until then, disclosures will have to be made on a “principle-level” and “best efforts” basis. Although this is generally feasible, many unanswered questions remain around product disclosure and attaining compliance with the provisions that will have the biggest adverse impacts. The draft were only issued in the beginning of 2021 adding further delays for application.

KEY CHALLENGES

Since this regulation is an important part of the sustainability agenda that will help the European economy achieve carbon neutrality by 2050, it is perceived as imperative to meet the deadline of March 10, 2021. That said, this date poses a major challenge, as the technical standards are not yet in place and barely released in draft mode early 2021.

As such, industry professionals will have to anticipate as best they can and adapt in an uncertain scenario until convergence is reached by the publication of the technical standards, template and accompanying taxonomy. Compliance with SFDR will thus mean firms attempting to achieve convergence with the high-level requirements based on best efforts and principles. Sourcing, collecting, and assembling the appropriate data will be challenging, and for some, filing prospectus amendments with the CSSF will be an onerous task.

Internal Governance

SCOPE

- Credit institutions
- Investment firms

CONTENT

In December 2020, the Commission de Surveillance du Secteur Financier (CSSF) updated Circular 12/552 on central administration, internal governance and risk management, aligning its expectations with a series of EBA guidelines. The CSSF now differentiates between requirements for banks (Circular 20/759) and investment firms (Circular 20/758).

The reason for this differentiation is that the CSSF considers the regulatory framework for credit institutions is increasingly diverging from that applicable to investment firms.

Maintaining a single Circular covering different entities and areas of activity was becoming verydifficult.. Hence, CSSF Circular 20/758 introduces new and updated requirements for investment firms, under the principle of proportionality.

Both CSSF Circulars 20/759 and 20/758 implement, inter alia, the EBA Guidelines on Internal Governance and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders.

The main changes being introduced relate to a wider scope of application, a clarification of the proportionality principle, increased supervision of the management body in terms of its diversity and independence, and requirements relating to environmental, social and governance (ESG) factors. Other requirements and clarifications include increased responsibilities for the Compliance function and an updated definition of significant institutions.

Both circulars entered into force on January 1, 2021. Banks and investment firms are therefore expected to be compliant with these obligations as of that date and be prepared to respond to any CSSF queries.

KEY CHALLENGES

Internal governance and risk management practices are among the central areas of scrutiny for the CSSF, and both credit institutions and investment firms need to ensure proper governance arrangements are in place in their organizations.

By incorporating multiple key priorities of EU regulators, such as diversity, ESG, proportionality, and enhanced risk management practices, these Circulars play a central role in the way credit institutions and investment firms should design their organizational arrangements, governance and strategic objectives.

With several amendments strengthening existing rules and new topics being included, impact on prevailing arrangements need to be carefully assessed and addressed.

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