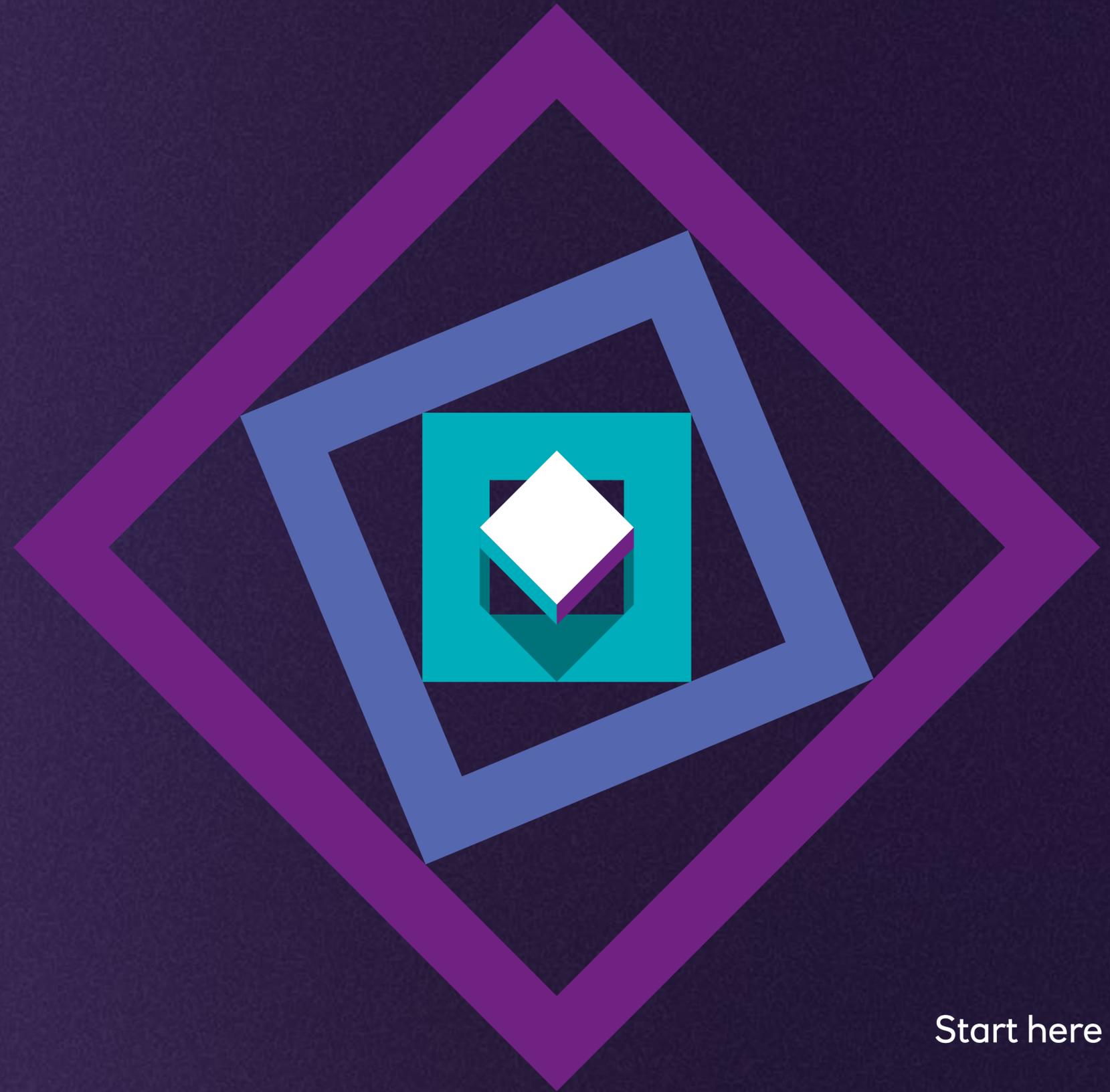


Depository Insights

Summer 2022





 watch now

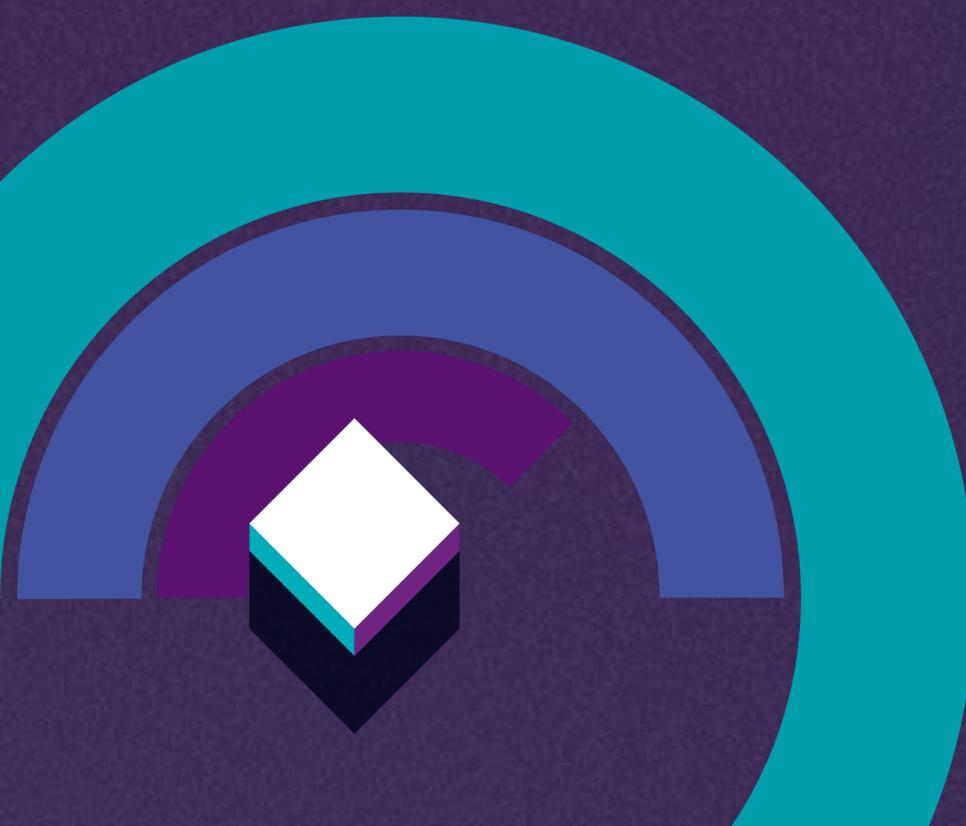
Peter Flynn

Associate, Funds Regulation & Governance

Foreword

Welcome to the Summer 2022 edition of Depository Insights.

NatWest Trustee and Depository Services team



In this issue we take stock of the year so far, and look ahead to what the main priorities are likely to be as the year continues to unfold.

Geopolitics has reordered the regulatory landscape, as matters such as side-pockets and sanctions, driven by global events, have risen to the top of regulators’ priority lists. The resulting reprioritisation has led to certain other developments being pushed back. A number of initiatives which were pencilled in for H1 2022 have slipped into H2. However, the regulatory agenda is as busy as ever: long-anticipated developments in areas such as ESG remain in the pipeline, while inflation and the cost of living have made other priorities such as the Consumer Duty all the more relevant. On top of this, regulators’ strategies and aspirations are expanding (as seen in the FCA’s latest Business Plan and three-year strategy), and emerging topics such as cryptoassets continue to generate debate – not least among policymakers.

This is therefore a good time to step back to consider not only where we are now, but what the next six months might hold.

Articles in this edition include:

- An overview of the regulatory landscape in H1 2022, and a look-ahead to H2
- Insights into the latest position on ESG
- A summary of the debates taking place on cryptoasset regulation
- The latest developments on the Consumer Duty and Consumer Investment Strategy

- **Foreword** >
- H1 in review:** expectations and events >
- Cryptoassets:** squaring the circle >
- ESG in 2022:** where are we now? >
- Consumer duty:** ever more relevant >

This is an interactive publication.
Click on any of the menu links to navigate between sections



H1 in review: Expectations and events

Towards the end of 2021 many firms will have looked ahead – their planning will have logically built on the major existing themes: ESG, Covid-19 recovery, post-Brexit competitiveness, fund governance and consumer protection.

However, multiple geopolitical forces already at play in 2022 have impacted the landscape for both firms and regulators. It is also clear that the pace of change will have to continue to escalate in H2.

Foreword	>
● H1 in review: expectations and events	>
Cryptoassets: squaring the circle	>
ESG in 2022: where are we now?	>
Consumer duty: ever more relevant	>

H1 in review: expectations and events

Events have disrupted the expected running order somewhat, as geopolitics forces firms and regulators to keep pace with a new economic reality:

Sanctions



Side-pockets



High inflation



Rising interest rates



This has necessarily made for a more reactive regulatory environment. The introduction of side-pockets has required a pivot in terms of FCA resources, which has had a tangible impact in terms of other consultation and policy activity. A number of items were pushed back: the second consultation on the Long Term Asset Fund (LTAF) for example, and the consultation on sustainability disclosures.

Looking at the latest Regulatory Initiatives Grid – an overview compiled by all the UK regulators, published in May – it is clear that these developments remain very much on the radar, but the Grid now deals in less specific dates: quarters, months, or in some cases even seasons. A sign of more uncertain times.

- Foreword >
- H1 in review: expectations and events >
- Cryptoassets: squaring the circle >
- ESG in 2022: where are we now? >
- Consumer duty: ever more relevant >

H1 in review: expectations and events

The side-pocket consultation has been notable in terms of the pace at which it was progressed: the consultation was open for a mere two weeks, with the policy statement issued in short order thereafter (06 July). It is an example of the regulator attempting to deliver change in an agile and efficient manner; albeit other regulators such as the CBI in Ireland, or ESMA have also demonstrated a desire to accelerate, arguably faster, on this issue.

The side-pocket initiative is an important data point to bear in mind in relation to the FCA’s Business Plan and three-year strategy, which were both published in Q2. In these, the FCA challenges itself to continue to be more assertive, innovative and adaptive and to focus on outcomes. In a busy geopolitical and market environment the FCA has tried to up the ante by challenging itself to continuously improve, with a more agile approach to regulatory change. Observers will be looking out for other examples of this approach in H2.



Overall, the remit is expanding: we saw climate change added to regulators’ remits in 2021, and in 2022 it has been proposed that supporting UK competitiveness should be added as a secondary remit for regulators. There is, therefore, a lot on the FCA’s plate at the moment, and the regulatory agenda, though slightly reordered, remains as busy as ever. The Regulatory Initiatives Grid is just as hefty as in previous iterations.

- Foreword
>
- H1 in review: expectations and events
>
- Cryptoassets: squaring the circle
>
- ESG in 2022: where are we now?
>
- Consumer duty: ever more relevant
>

H1 in review: expectations and events

Looking ahead to H2:

What can firms expect in H2?

Firstly, we now have clarity on the side-pocket issue, with the publication of the Policy Statement on 06 July. Some firms will make use of the proposals to help affected funds to come out of suspension. Others will consider other options in conversation with the FCA. A number of UK funds are currently suspended and the implementation of side-pockets may bring this number down. Enabling investors to once again be able to redeem where appropriate would ultimately represent a positive outcome for consumers and the market.

Linked to this, the cost of living crisis and high inflation will increase focus on the Consumer Duty and the principle of treating customers fairly, as well as the FCA's Consumer Investment Strategy. Consumer Duty is a principle area of focus for many firms, although larger firms have argued that they are already meeting the requirements of the Duty, albeit perhaps with a need to document this more clearly. These initiatives will only gain in relevance in H2, as the policy statement is issued and implementation commences.

We will also see a return to the big themes we expected to see at the start of the year: ESG, fund governance, LTAFs, and further efforts to shore up the regulatory position on emerging, contentious matters such as cryptoasset regulation.



It is clear that the pace of change will have to continue to escalate in H2.

However, regardless of how the rest of the year unfolds, the primary principles of **consumer protection and market integrity will remain consistently front-and-centre.**

When planning ahead, even in uncertain times, these are always the guardrails which firms should hold on to.

Foreword	>
● H1 in review: expectations and events	>
Cryptoassets: squaring the circle	>
ESG in 2022: where are we now?	>
Consumer duty: ever more relevant	>

Cryptoassets: squaring the circle

In April HM Treasury (HMT) set out its approach to making the UK a global hub for cryptoassets.

Proposals included bringing stabletokens within the regulatory perimeter, considering further normalisation of cryptoassets and associated innovation (e.g. distributed ledger technology and blockchain) and pencilling in further consultation on these matters later in the year. This followed 2021's call for input on stabletokens. It was also proposed that the Royal Mint issue a non-fungible token (NFT) as a marker of the UK's intent to lead the way.

Foreword >

H1 in review: >
expectations and events

● **Cryptoassets:** >
squaring the circle

ESG in 2022: >
where are we now?

Consumer duty: >
ever more relevant

Cryptoassets: squaring the circle



This follows a growing interest in cryptoasset investments on the part of investors, for whom exposure has become more common, in spite of the much-publicised risks and price volatility.

These risks have also triggered a distinct difference of opinion between HMT and the FCA. On the one hand, where HMT's stance could be described as 'bullish', the FCA, emphasising its consumer protection remit, has consistently highlighted the risks to investors. Statements regularly draw attention to the possibility of investors losing their money. This has become especially palpable amid the so-called 'crypto winter' in which prices have fallen significantly.

In April, the FCA issued a particularly direct statement on cryptoasset risks. In it, the regulator noted that such investments, including NFTs, are outwith the regulatory perimeter, and are not protected by the Financial Services Compensation Scheme. Effectively, the FCA was saying 'buyer beware'.



- Foreword >
- H1 in review: expectations and events >
- **Cryptoassets: squaring the circle** >
- ESG in 2022: where are we now? >
- Consumer duty: ever more relevant >

Cryptoassets: squaring the circle

This difference of ethos between UK policymakers and regulators will ultimately need to be resolved.

The key challenge is clearly how to square the circle of boosting the UK's position as a hub for cryptoassets while also maintaining high standards of governance and investor protection. Key risks for depositaries include monitoring to avoid breaches, volatile prices and resulting challenges regarding valuation.

There is also a difference between how this matter is being addressed in the UK and in the EU, where the proposed Markets in Cryptoassets regulation (MiCA) represents a sizeable effort to harmonise regulation across jurisdictions (implementation is expected 2023-24).

Foreword >

H1 in review: >
expectations and events

● Cryptoassets: >
squaring the circle

ESG in 2022: >
where are we now?

Consumer duty: >
ever more relevant

What next?

We know that there will be further consultation on this later in the year, including on the regulatory perimeter.



The world is changing and demand is growing. This means it is important for everyone that regulators and policymakers try to form a more consistent position.

ESG in 2022: where are we now?

In late 2021, a series of major announcements were issued by the UK government to coincide with the COP26 climate change conference in Glasgow.

One of the set pieces was the Greening Finance Roadmap, which, among other things, proposed the introduction of the Sustainability Disclosure Requirements (SDR) and Green Taxonomy, to help support investors to have confidence that ESG-branded products are delivering in line with expectations, helping to mitigate the risk of greenwashing.

Foreword	>
H1 in review: expectations and events	>
Cryptoassets: squaring the circle	>
ESG in 2022: where are we now?	>
Consumer duty: ever more relevant	>

ESG in 2022: where are we now?



As with a number of other developments, the SDR and Green Taxonomy have been reprioritised somewhat due to market developments in H1. The work of translating some of the aspirations of COP into consultation and policy is still, therefore, ongoing.

The global regulatory approach to ESG has not stood still, however, and a number of other developments have risen to prominence in H1 which impact funds and depositaries.



In June, the European Securities and Markets Authority (ESMA) issued a supervisory briefing on ESG disclosures, with a specific reference to the role of the depositary, noting that:

"National Competent Authorities should ensure, through appropriate actions, that all relevant information and data are provided by the UCITS management companies and AIFMs to the appointed depositary to enable it to perform effectively the relevant depositary functions. In particular, depositaries should include all ESG-related investment restrictions in the monitoring of the compliance of the instructions coming from the management company or the fund manager."

On 31 May ESMA also noted, in a speech, that:

"We have to recognise the complexities involved and the challenges for retail investors, as well as the risk of greenwashing."

In the EU, momentum is therefore building behind enhanced standards for governance and transparency – to mitigate risks of consumer harm.

In May, the Securities Exchange Commission in the US issued new guidance on ESG naming and disclosure, expanding the “names rule” so that certain ESG funds are required to invest at least 80% of the portfolio in those investments. Enhanced disclosure rules have also been proposed to promote consistent, comparable and reliable ESG information for investors, and to require funds and advisors to provide more specific disclosures in fund prospectuses, annual reports and advisor brochures.



- Foreword** >
- H1 in review:** >
expectations and events
- Cryptoassets:** >
squaring the circle
- ESG in 2022:** >
where are we now?
- Consumer duty:** >
ever more relevant

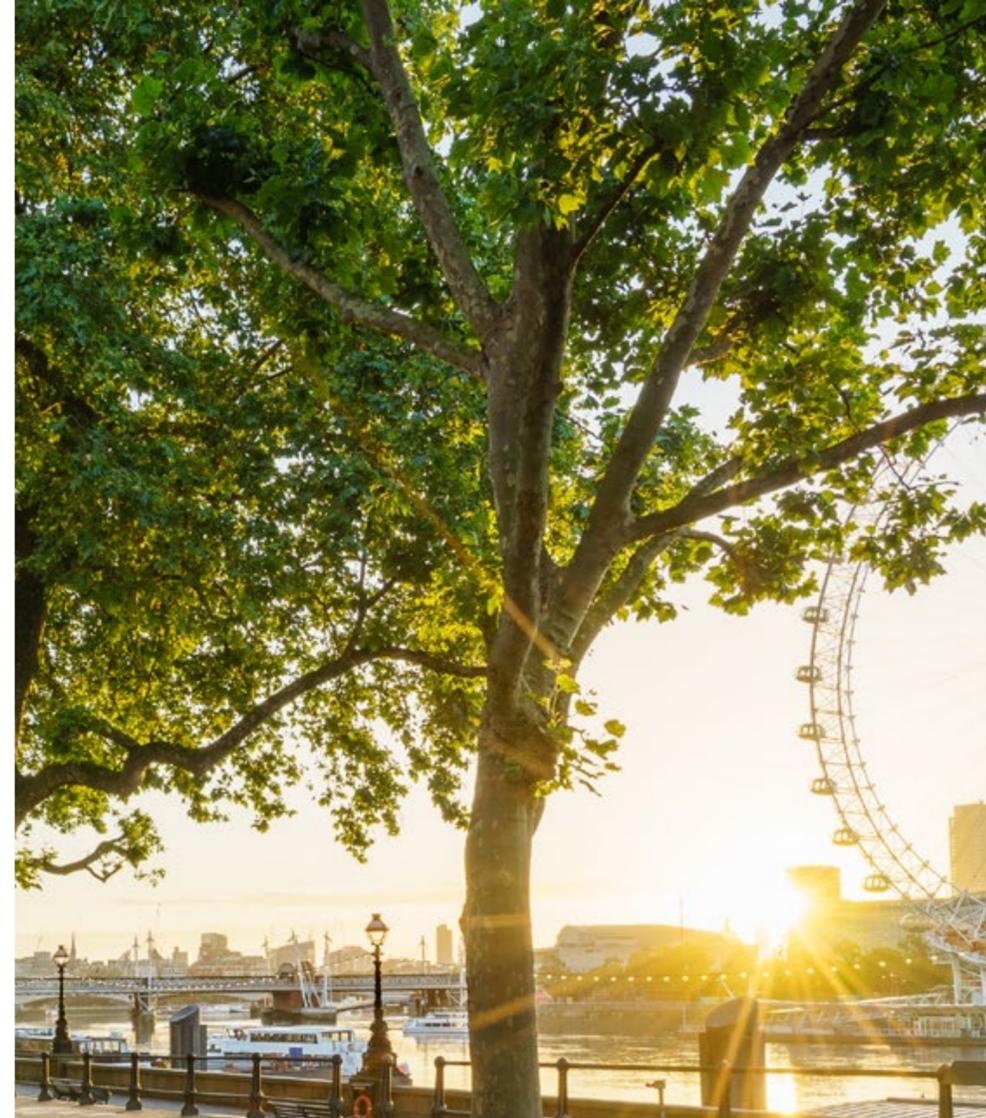


ESG in 2022: where are we now?

The net impact of this is to consolidate a global momentum behind greater accountability, transparency and auditability, with a greater role for governance, supervision and oversight in the best interests of investors.

While the major UK regulatory developments pencilled in for this year have been rearranged somewhat, ESG remains very much on the radar and these key priorities will be addressed in H2.

Regardless of what is on the horizon, there is in any case plenty of business-as-usual activity, including reporting, which many firms will need to focus in on, such as Taskforce on Climate-Related Financial Disclosures (TCFD) reporting, Stewardship Code submissions, and alignment with the UN's Principles of Responsible Investment.



From a UK perspective there has been no indicator of a regulatory response to the ESMA or SEC statements at this stage. However, given that the Greening Finance Roadmap emphasised the UK's desire to become a leading jurisdiction for ESG investing, it is a case of “when, not if” in terms of further efforts to shore up accountability, transparency and good governance in the best interests of investors, in order to remain competitive and avoid lagging behind other jurisdictions.

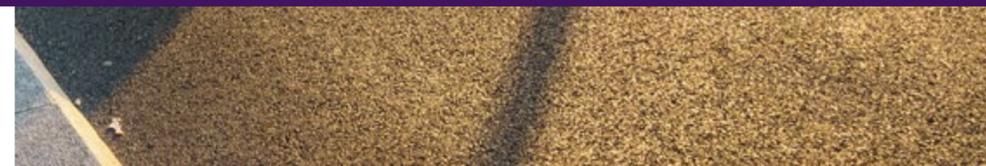
Foreword >

H1 in review: >
expectations and events

Cryptoassets: >
squaring the circle

● ESG in 2022: >
where are we now?

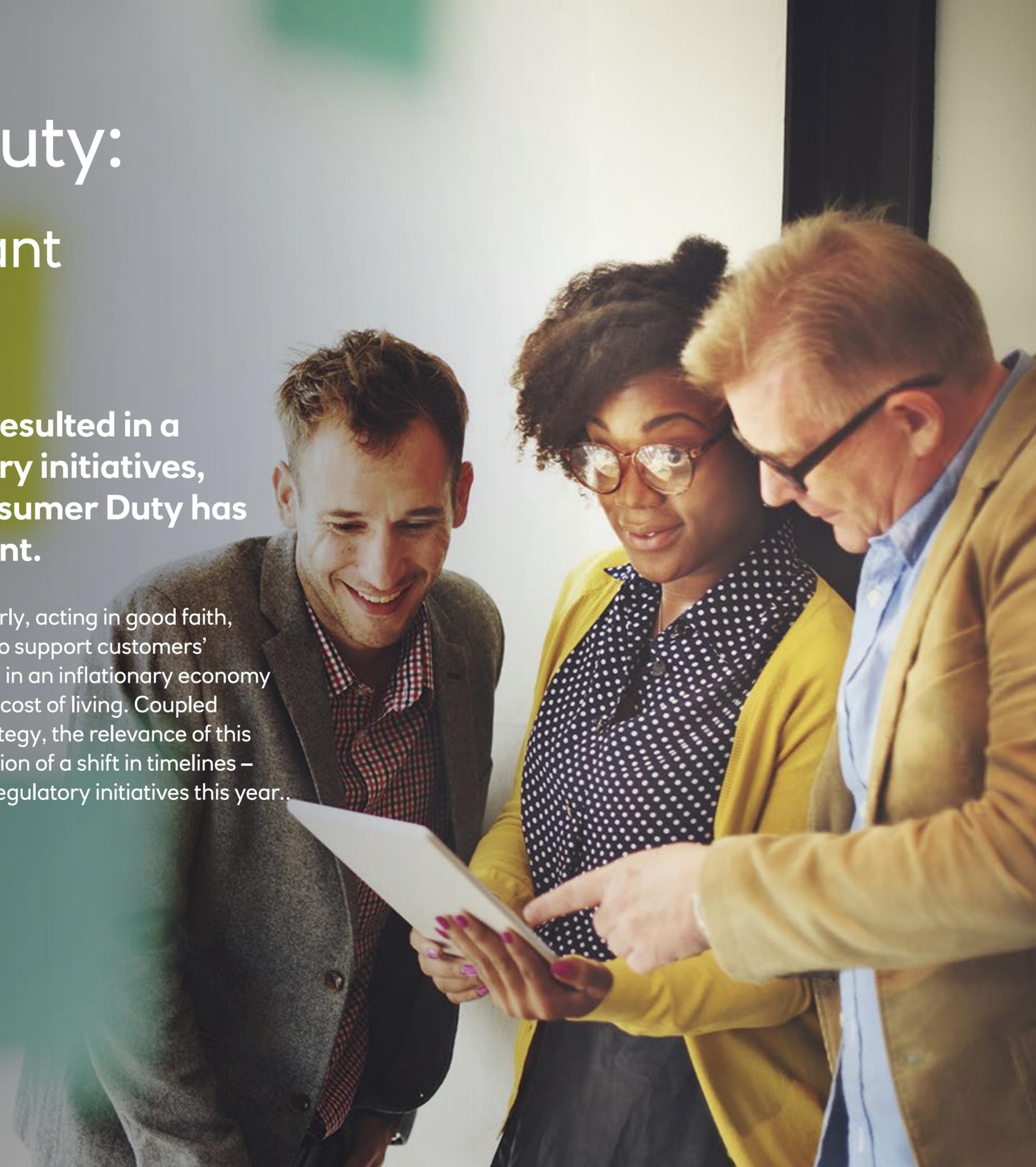
Consumer duty: >
ever more relevant



Consumer Duty: ever more relevant

While recent events have resulted in a reprioritisation of regulatory initiatives, the FCA’s work on the Consumer Duty has become ever more pertinent.

Its core principles of treating customers fairly, acting in good faith, avoiding foreseeable harm, while helping to support customers’ financial objectives are all the more critical in an inflationary economy with rising interest rates and a squeeze on cost of living. Coupled with last year’s Consumer Investment Strategy, the relevance of this initiative continues to grow, with no indication of a shift in timelines – something which cannot be said of other regulatory initiatives this year..



- Foreword** >
- H1 in review:** >
expectations and events
- Cryptoassets:** >
squaring the circle
- ESG in 2022:** >
where are we now?
- Consumer duty:** >
ever more relevant

Consumer Duty: ever more relevant

The Consumer Duty has been on the books for some time...

A discussion paper was issued in 2018, with consultation papers in 2021 and 2022. The Duty features prominently in the Business Plan and the FCA’s three-year strategy and is also highlighted in the Regulatory Initiatives Grid. It is fair to say that it is considered a top priority.

The scale and ambition of the Duty is also notable: it is a sizeable change to be delivered in a tight timeframe. The policy statement is expected in late July with implementation set for April 2023. Any firm along the distribution chain which could have a material impact on consumer outcomes is in scope, which gives an indication of the breadth of impact that the proposals will have on the wider industry.

There had been some push-back from consultation respondents in terms of the tight implementation period: some argued that more than nine months was required in order to ensure that the Duty was implemented effectively. There was also pushback against some aspects of the proposed rules, with some respondents arguing that there was duplication in some places with existing regulation.

However, the FCA has advised firms to commence implementation based on the content of the consultation papers, which indicates that substantial changes based on feedback are not to be expected in the policy statement when it is issued. Many firms have commenced with implementation on this basis.

The four key areas of focus:

Once firms have formed a view that they are in scope, they are required to address the Duty’s four focus areas:



- Foreword >
- H1 in review: expectations and events >
- Cryptoassets: squaring the circle >
- ESG in 2022: where are we now? >
- Consumer duty: ever more relevant >

Consumer Duty: ever more relevant

The four focus areas are a big step up from existing rules such as the principles around treating customers fairly, and the proposals represent a sizeable new change programme for in-scope firms.

Circumstances make the **Consumer Investment Strategy** ever more relevant as well, in terms of its focus on delivering good outcomes for consumers and mitigating the risk of consumer harm: there is the potential for harm, for example, if cash savings are eaten away by inflation. Investments may provide better outcomes and hence the strategy aims to widen access to investments where appropriate.

To facilitate this, a new **framework** has been proposed, to make the market safer and more attractive so that more of those who could benefit from investments have access to appropriate channels in which to do so.

This framework is based on:



The heavy regulatory agenda has not reduced the impetus behind Consumer Duty or the Consumer Investment Strategy; in fact it has grown and is arguably more pressing than ever.

For many firms, implementation has already begun on a transformation which will be front and centre of regulatory change programmes for the foreseeable future. And the key to this will be enforcement – when the FCA sees things going wrong, they will need to be ready and willing to take action.

- Foreword >
- H1 in review: expectations and events >
- Cryptoassets: squaring the circle >
- ESG in 2022: where are we now? >
- Consumer duty: ever more relevant >

Depository Insights

Summer 2022

Funds Regulation and Governance contact:

Peter Flynn

Associate, Funds Regulation
and Governance

peter.flynn@natwesttds.com

NatWest Trustee and Depository Services Limited. Registered in England and Wales No. 11194605. Registered office: 440 Strand, London, WC2R 0QS. Authorised and regulated by the Financial Conduct Authority. While the information contained in this presentation is believed to be correct at the time of issue, NWTDS will not accept any liability in any circumstances for its accuracy, adequacy or completeness, nor will any express or implied warranty be given. This exclusion extends to liability howsoever arising in relation to any statement, opinion or conclusion contained in, or any omission from, this document and in respect of any other written or oral communication transmitted (or otherwise made available) to you. No representations or warranties are made in relation to these statements, opinions or conclusions. This exclusion does not extend to any fraudulent misrepresentation made by, or on behalf of, NWTDS.



NatWest
Trustee and
Depository Services