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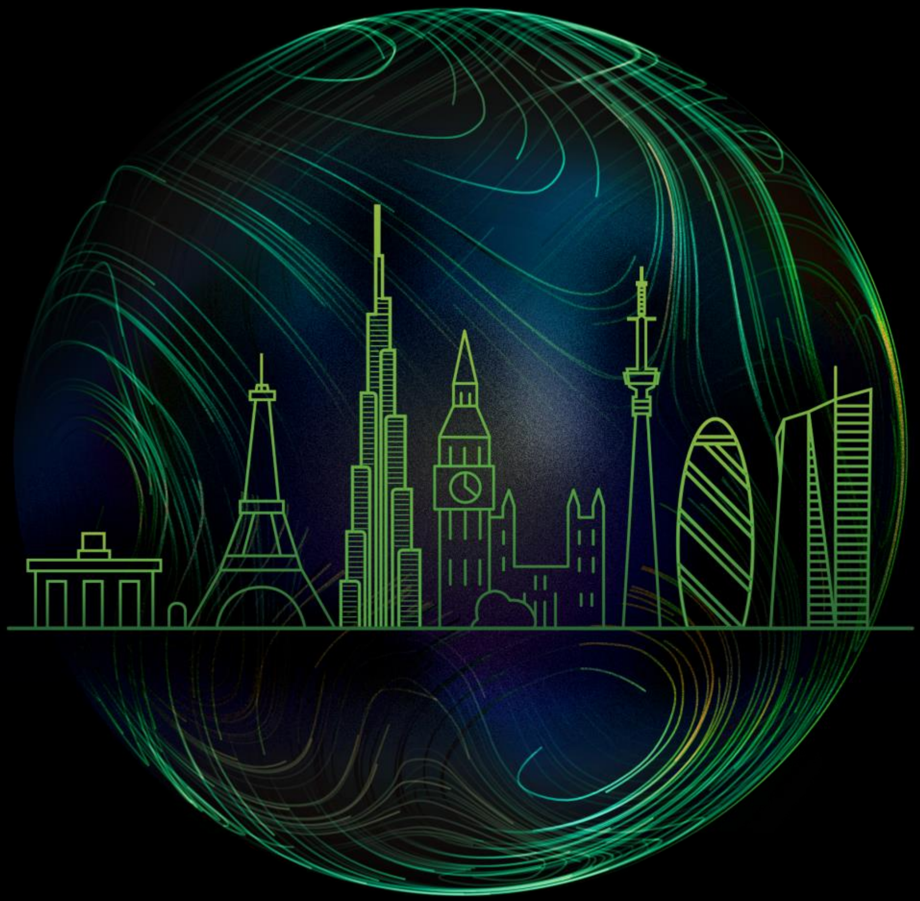


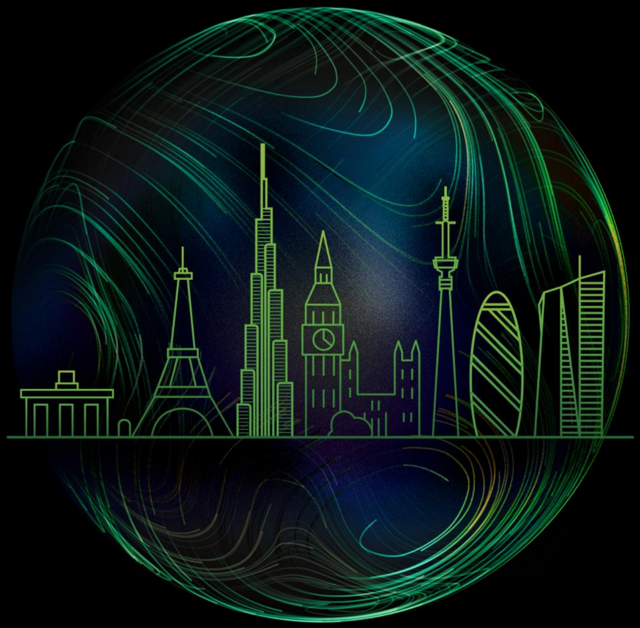
Investment Management and Wealth

Financial Markets Regulatory Outlook 2024

CENTRE *for* **REGULATORY STRATEGY** **EMEA**

Regulatory Outlook 2024

Investment management and wealth – at a glance



Implementing the Consumer Duty

Firms under intense supervisory scrutiny

Impact Areas

- Governance
- Strategy
- Finance
- Operations
- Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- The FCA has shown its willingness to use all its supervisory tools to monitor compliance with the Consumer Duty (the Duty). Fund and wealth management fees and overall value will be in the spotlight. Firms should consider their metrics and data to help them identify areas where the FCA is likely to challenge and scrutinise them.
- Firms will face challenge from the FCA on the quality of their MI to evidence good customer outcomes and consideration of foreseeable harm – they will need to consider carefully whether their data is robust.

WHAT'S HAPPENING THIS YEAR?

- Firms will be working towards compiling the evidence and engaging with the Board to produce and approve their first **Duty Board report** to evidence compliance before 31 July 2024. We expect the FCA to scrutinise the reports closely and challenge weak assumptions and lack of relevant data and evidence.
- A current industry sticking point is **information-sharing** between manufacturers and distributors, especially along complex distribution chains - we would expect the FCA to intervene if lack of cooperation impedes this.
- **Value assessments** will be a key focus in the FCA's 2024 review of Duty embeddedness. The FCA will expect firms to consider the findings of its 2023 AFM value assessments review and recent portfolio letters. Many firms assessing value for the first time under the Duty are grappling with how to measure the value of a service - while this may start as a qualitative exercise, we think it needs to be backed up by tangible evidence and data.
- The FCA's wealth data survey finding that 49% of portfolio managers and 69% of stockbrokers had identified no **vulnerable customers** suggests many firms need to look again, given the FCA's wide definition of vulnerability.
- Firms need to **embed a culture** that facilitates good customer outcomes. They need to consider how their governance structures, training, remuneration and incentives are aligned with the Duty, and how all staff understand what part they need to play. This needs to be consistent across all parts of the business.
- **Closed products** will come under the Duty's scope by July 2024. The FCA expects firms to accelerate their work on value for closed products if they suspect customer harm.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERES IN 2024

Consumer Duty Board report to evidence compliance

- Firms should review their current data and MI and evaluate whether they are sufficient to evidence compliance with the Duty.
- Firms should allow the Board and Duty Champion plenty of time to challenge the adequacy and credibility of the evidence that has been gathered.
- Manufacturers and distributors need to work together to facilitate information-sharing, and to invest in IT systems to collect/disseminate and analyse the data.

Value assessments

- The FCA expects firms to consider each assessment criterion carefully rather than simply using comparable market rates to justify fees.
- The FCA has highlighted that firms need to consider whether they are passing on a fair share of revenues (e.g. interest on cash balances, revenues from securities lending) as well as looking at charges.

Vulnerable customers

- Firms that have direct contact with end customers need robust processes for identifying vulnerable customers and providing appropriate support.
- Manufacturers need to consider factors such as accessibility of product literature.

Embedding the Duty into the firm's culture

- Establish clear accountability and governance frameworks, setting the right "tone from the top" to foster an environment where all staff understand their role in delivering good customer outcomes.
- Review recruitment processes, training, remuneration and incentives programmes to ensure they capture the Duty requirements.

Closed products

- Develop an inventory of closed products to assess changes needed by July 2024.
- Accelerate changes where potential customer harm has been identified.

Greenwashing, disclosures & data

Strengthening defences against a pervasive risk

Impact Areas

- Governance
- Strategy
- Finance
- Operations
- Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- The focus for firms in 2024 should be on: identifying greenwashing risk; putting in place appropriate controls and risk management; and understanding the implications for products and firm-level commitments
- Firms in the UK should also be prepared to be supervised for greenwashing as part of the Duty.
- Making clear, accurate and comprehensive ESG disclosures at firm and product level will continue to be a key theme across the UK and EU for those firms that want to avoid greenwashing claims and remain competitive.

WHAT'S HAPPENING THIS YEAR?

- In the UK, implementation of the SDR final rules for investment management - published in Q4 2023 - will be a focus for affected firms. In the EU, ESMA's restrictions on ESG terms in fund names, also expected to be published in Q2 2024, will similarly have a significant effect on the marketability of sustainable funds. We expect the SFDR review to go on through 2024, however, so there will be no new action for firms from this.
- An additional consequence of the SDR final rules is that investment management firms need to comply with the FCA's anti-greenwashing rule from May 2024.
- ESMA will publish a final report on how greenwashing risks manifest in the investment management industry in the EU, and will conduct a Common Supervisory Action on MiFID II sustainability requirements. Both of these may result in actions for firms to address risks and meet supervisory expectations.
- On ESG data specifically, larger EU firms must report for the first time for FY2024 under the EU's CSRD against the sector-agnostic standards in ESRS (reports need to be published in 2025). In the UK, the government has committed to endorsing ISSB standards and implementing them through the SDS framework. We expect the FCA to consult during H1 2024 on making SDS disclosures mandatory for listed firms from 1 January 2025.
- Not all investment managers will have to disclose under the CSRD or the SDS. However, even if they do not, they will benefit from the increased availability of ESG data from those that do report and can enhance their own regulatory disclosures under SFDR/SDR. Firms should prepare to make use of better ESG data by ensuring they have the right internal ESG data strategies and the systems to view and sort the data.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Expand scope of greenwashing mitigation work

- Reviewing regulatory disclosures and marketing documents for misleading and exaggerated claims is necessary but not sufficient. Firms must conduct a risk-based review across all relevant functions and activities – including governance, stewardship, KPIs, technical expertise, operations and culture – to determine potential sources of intentional and unintentional greenwashing risk.
- For each product, firms need to ensure there is an end-to-end control framework in place, from product design to sustainability performance reporting. Experts in risk and compliance, product governance, ESG data and stewardship need to be involved.
- Firms should consider whether their existing range of sustainable funds and firm-level net zero commitments remain viable.

Enhance ESG data collection, methodologies and governance

- Firms should examine their current ESG data practices, including data collection, assumptions and methodologies. Particular attention should be given to Scope 3 emissions, as it is the most nascent area in terms of data availability and has the highest impact on a firm's emissions.
- Firms should ensure they have an ESG data strategy underpinned by strong governance.

Identify overlaps and synergies with other regulatory requirements

- Firms should consider synergies between greenwashing regulations and other requirements.
- In the UK, firms should pro-actively view their greenwashing risk mitigation process, ESG data strategy and SDR disclosures through the lens of the Duty.
- Duty implementation may be leveraged to implement SDR in some areas.

Transition planning

Turning ambitions and blueprints into action

Impact Areas

- Governance (red)
- Strategy (red)
- Finance (amber)
- Operations (red)
- Control functions (Risk/Compliance/IA) (amber)

KEY CHALLENGES

- Even before more detailed regulatory guidance is finalised, firms need to step up their efforts on transition planning, to formulate plans that drive the business and which firms are confident to publish.
- Who pays for the transition to net zero will be a political hot potato in the run-up to parliamentary elections in the EU and UK. This will in turn increase uncertainties for firms about the direction and pace of the economy-wide transition. Firms will also need to consider how their transition plans might need to be adjusted to balance broader risks to society and to nature, particularly as recommendations from TNFD are taken forward.

WHAT'S HAPPENING THIS YEAR?

- In the UK, we expect firms to **progress transition planning, looking to ISSB standards and TPT recommendations**, in advance of the FCA updating its disclosure requirements – which we expect to enter into force for accounting periods on or after 1 January 2025 (reporting in 2026).
- In the EU, CSRD includes **transition plan disclosures** and will apply to larger EU firms from FY 2024 (reporting in 2025). CSDDD is also likely to be agreed in 2024, introducing additional expectations on **transition planning and transition plan disclosures** that will take time to implement.
- We also expect policymakers to turn their attention to how the regulatory framework constrains **transition finance.** There are concerns that under current rules, as firms seek to manage transition risk and meet climate targets, they may reduce funding and investment to areas that need it to transition. We anticipate that progress to balance that need alongside tackling climate risks will be slow.
- As the foundational aspects of transition planning mature, policymakers will switch their focus to some of the more complex aspects, including how to assess **transition plan credibility**, and who is best placed to do so. Validation of targets will also increase in importance as some firms choose to set or update targets in line with the new SBTi FINZ framework, expected to be finalised in 2024.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Enable an organisational mindset shift

- Transition plans should be living documents that reflect how the Board is steering the firm towards its sustainability commitments and transforming the business to respond to sustainability risk and opportunities. Transition planning should be viewed as an aspect of strategy, rather than solely a disclosure exercise, and be embedded across the organisation, including financial planning.
- Firms face significant uncertainties, such as on policy action and technological developments, and the TPT provides guidance to identify and assess key assumptions and external factors on which transition plan success depends.

Take a strategic and rounded approach to transition planning

- Firms can use the transition planning process to drive discussion internally on potential tensions between transition risk, transition ambitions and the economy-wide transition and how to navigate them.
- Firms should assess how their transition levers affect or depend on e.g., society and nature, and identify interconnections with related regulatory workstreams e.g., the Duty and supply chain management, to avoid undermining the transition plan or broader strategic ambitions.

Set out an implementation and engagement strategy

- Firms need to secure the resources and individuals with climate expertise required for transition plan implementation. The project needs to define the incremental steps and delivery teams necessary to achieve the targets.
- Understanding portfolio/product level emissions, engaging with portfolio companies and understanding asset owners' preferences on an ongoing basis are key for investment management firms' transition plans.

Fund liquidity

Enhancing resilience

Impact Areas

Governance | Strategy | Finance | Operations | Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- Senior management will need to have greater oversight of fund liquidity risk management in view of the new UCITS/AIFMD rules and the FCA's expectations. We think that firms should have a dedicated fund liquidity risk management committee where proportionate to the firm's size and structure, and that this should particularly focus on model governance and validation, and on providing enhanced governance in times of market stress.
- Firms will need liquidity management processes that are tailored to each type of fund, with clear escalation triggers and approaches under different scenarios – this will be a significant task for many firms.

WHAT'S HAPPENING THIS YEAR?

- In the EU, implementing the new UCITS and AIFMD rules will be a key focus. Firms will need to select at least two liquidity management tools for each fund and implement detailed policies, procedures and operational arrangements for the use of each tool.
- In the UK, the FCA's recent review of fund liquidity management found significant shortcomings and the FCA expects to see a step change in how Boards and governance committees engage on this topic.
- To monitor liquidity risk effectively, firms will need metrics, escalation triggers and processes (including the use of anti-dilution tools) that are tailored to each asset class and calibrated for the risk profile of each fund.
- In view of IOSCO's guidance on anti-dilution tools and FCA expectations, firms will need to build market impact cost into swing pricing and other anti-dilution tools. This will require them to apply judgement and we think that firms' governance processes should pay particular attention to their models.
- Firms should ensure that they have robust liquidity risk stress tests with sufficiently severe scenarios and conservative assumptions. Firms should consider using a "pro-rata" approach (where a proportionate "slice" of every asset comprising the portfolio is sold to accommodate the redemption) where appropriate.
- Managers of funds investing significantly in illiquid assets will need to review their redemption terms in view of the FSB's recommendation that that funds investing significantly in illiquid assets should not have daily dealing, and new rules expected from the FCA on redemption notice periods for open-ended property funds.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Governance

- Ensure that fund liquidity risk has sufficient governance and oversight e.g. via a dedicated liquidity risk management committee where appropriate.
- Review MI to ensure sufficient escalation. For example, committees should regularly review trends of redemptions, the evolution of liquidity buckets within funds and strategies, valuation, and the use of dilution adjustments - all with increased frequency during volatile market conditions.
- Enhance model governance and model validation (including on models for swing pricing, stress testing and asset valuation).
- Ensure redemption terms are aligned to the liquidity profile of the fund's assets.

Stress testing

- Enhance fund liquidity risk stress tests to consider wider macro-economic influences and sufficiently severe scenarios, and to use conservative assumptions, including a "pro rata approach" where appropriate.

Liquidity management tools

- Create playbooks tailored to each fund which set out escalation triggers and processes based on different liquidity stress scenarios.
- Build a model to estimate market impact cost using relevant market data – firms' models should be subject to robust governance and back-testing.
- Conduct pre- and post-redemption testing to ascertain how liquidity has been affected by redemptions.

Oversight of third parties

- Engage with third parties (e.g. delegated investment managers and third-party administrators) to ensure that they have appropriate liquidity management arrangements in line with the firm's own liquidity risk appetite.

Operational resilience

Last year of implementation

Impact Areas

Governance · Strategy · Finance · Operations · Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- As operational resilience rules in the UK and EU approach their final implementation year, firms need to move from embedding and building compliance to demonstrating resilience in practice to supervisors. The new regimes will require firms to reach a new level of maturity in their resilience capabilities compared to what they are used to, particularly around scenario testing and vulnerability remediation.
- The DORA's challenging implementation timeline may add a further layer of complexity, as firms will likely need to begin implementation work before full ratification of secondary standards.

WHAT'S HAPPENING THIS YEAR?

- The UK's operational resilience regime will become fully applicable in March 2025. This means 2024 will be the last full year for firms to embed their new target operating models and address any supervisory feedback. Firms recording significant deviations from peers in their impact tolerances will likely need to revisit their framework.
- The BoE, FCA and the PRA will use the feedback gathered during the relevant consultation to finalise their proposed oversight regime for CTPs to the FS sector and will also consult on a framework for incident, outsourcing and third-party reporting. New CTP regimes will provide more supervisory oversight but will not replace existing and new TPRM duties for FS firms, which will still require significant effort.
- EU DORA will fully apply in January 2025 and will affect both FS firms and ICT CTPs. Similar to its UK counterpart, 2024 will also be the final implementation year, during which secondary standards providing key technical detail will also be finalised. The European Supervisory Authorities will submit their final drafts to the Commission in two main batches, due respectively in January and July 2024. The Commission will then review and ratify each standard.
- The EU's Cyber Resilience Act is expected to be finalised and published in the EU's Official Journal by H1 2024. While its applicability to FS is still under discussion, chances are that it will complement the DORA's organisational resilience rules, setting minimum cyber resilience standards for digital products.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Demonstrate resilience maturity in different contexts

- With only one year left before full applicability, firms in both the UK and the EU will be required to demonstrate similar levels of resilience maturity despite having different levels of experience and clarity around supervisory approaches.
- This will require a high level of Board/top management involvement in the EU, as they will have to steer and approve ambitious policies and hold ultimate accountability.
- In the UK, testing will rise in importance relative to other priorities such as mapping, forcing firms which have not already done so to think about how to demonstrate the effectiveness of their plans in real life (e.g., through risk-scenario simulation testing).
- All change programmes will need to consider their impact on the firm's resilience.

Engage with regulators and industry

- Implementing resilience will not only be a new task for firms but also for the supervisors themselves. Firms will have to act early to develop and maintain a dialogue with them and reach an understanding on what "good" looks like.
- Working with industry peers (e.g., through trade organisations) will also be key in developing a sector-wide approach to shared implementation challenges, such as negotiating third-party participation in firms' own resilience testing.

Focus on TPRM

- Even though the new CTP oversight regimes will contribute to generating a more secure outsourcing environment, regulators have been very clear that these new rules will not in any way detract from the FS firms' own TPRM duties.
- Investment managers will need to work with TPPs to ensure that their impact tolerances are aligned and carry out joint testing with TPPs where possible.
- Consider opportunities to diversify TPPs where dependencies are concentrated.

Private market investments

Under the spotlight

Impact Areas

- Governance
- Strategy
- Finance
- Operations
- Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- We expect to see a step change in the level of supervisory scrutiny of private market investments, driven primarily by rapid growth in the market and regulatory concerns about a lack of transparency leading to the risk of inaccurate valuations, hidden leverage, conflicts of interest or unsuitable retail investment.
- Private markets firms will need to invest significantly to ensure that risk and compliance functions are appropriately resourced and that they have robust risk frameworks and operational processes.

WHAT'S HAPPENING THIS YEAR?

- **Valuation** will be a focus area, given the FCA's upcoming review of valuation in private markets and ESMA's CSA on valuation, which highlighted particular risks for private equity and real estate funds. Key concerns include subjectivity and potential conflicts of interest in the valuation process, and misalignments between the frequency of the NAV calculation, the asset valuation, and the availability of up-to-date data.
- Managers of **private credit funds** will need to consider their business strategy in light of AIFMD II's new harmonised regime for loan origination funds. This creates new opportunities for these funds to lend on a cross-border basis across the EU. It also introduces some significant new requirements, including leverage limits, risk retention requirements and a requirement to have a closed-ended structure unless they can demonstrate appropriate liquidity management practices for an open-ended structure.
- More managers are seeking **investment from retail investors** (including DC pensions and wealth clients). For example, a December 2022 global survey of 100 fund managers by Dechert found that about 40% of respondents had seen increased interest in setting up funds raising capital from retail investors over the preceding 12-24 months. In the UK, we expect the Duty to be a key supervisory focus area. DC pension schemes increasing their investment in unlisted assets under the Mansion House Compact will need to ensure their members understand the risks and that the investments deliver value net of fees.
- **ESG data** will continue to be a key concern and complying with the SDR will be a particular challenge for private market firms due to the difficulty in some cases of obtaining ESG data from private companies. Firms will need to work closely with investee companies to obtain high quality data.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Valuation

- Firms will need to ensure that their valuation process includes robust challenge which is independent and has the right level of seniority and expertise.
- The valuation process should be clearly documented. Firms should challenge themselves on why they have chosen particular valuation methodologies.
- Firms should review their data quality and ensure that the assumptions behind their models are robust and periodically back-tested.
- Firms should ensure they have sufficient skills and resources to produce valuations in-house or to scrutinise the work of third-party valuers robustly.

Private credit funds

- EU funds that do not currently meet the new AIFMD requirements (e.g. leverage limits, risk retention, fund structure) will need to review their investment strategy and/or structure to ensure they can remain attractive to investors.

Retail investment

- Firms marketing funds to retail (including DC pension or wealth management) clients should review their target market, distribution strategy, investor categorisation, and appropriateness and suitability tests.
- Firms subject to the Consumer Duty should ensure they have robust value assessments and have tested their customer communications where relevant.

Sustainability

- Firms will need to make best use of the CSRD to address data concerns. General Partners will need to work closely with portfolio companies to ensure that they are familiar with the CSRD and, where it applies, are prepared to comply.
- SDR will be a particular challenge for private fund managers – to use the labels they will need to engage extensively with companies to obtain ESG data.

Digital assets

Navigating an evolving and fragmented landscape

Impact Areas

- Governance
- Strategy
- Finance
- Operations
- Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- Tokenisation will dominate investment managers' digital asset pilots, with an initial focus on replacing traditional systems to record a fund's unitholders with DLT. Building initial capabilities will be helpful for "first mover" investment managers and pave the way for more complex use cases.
- Investment managers with plans to offer clients direct exposure to unbacked digital assets should prioritise defining an approach to custody and trading. In our experience, this can take 12-18 months to implement.

WHAT'S HAPPENING THIS YEAR?

- Investment managers continue to explore **fund tokenisation** – the distribution of funds via DLT tokens, rather than shares/units. UK pilots have lagged European peers. However, a UK industry blueprint – issued in collaboration with the FCA (as observer) and HMT – sets out a phased approach for firms planning pilots.
- Initially, the blueprint enables investment managers to pilot replacing an authorised fund's traditional unit register with tokens on a private, permissioned DLT. This innovative approach will allow for a single, real-time record-keeping system shared across all firms servicing the fund, eliminating the need for reconciliations and reducing fund administration costs. This is the beginning of the tokenisation journey for investment managers. Further stages – such as innovation in settlement processes – are to follow. However, building capabilities will be a helpful investment for investment managers with ambitions to be first movers in implementing fund tokenisation.
- Emerging regulatory clarity means that some investment managers may also explore offering their customers direct exposure to **unbacked digital assets** (e.g., Bitcoin).
- The EU framework for unbacked digital assets – MiCAR – is more developed than the UK regime, with clarity on primary legal requirements. Nevertheless, some detailed EU requirements are yet to emerge, especially for investment managers. Notably, ESMA will define guidance on rules for advice and portfolio management, but it will only be finalised by end-2024. In the meantime, firms exploring this product should start by defining an approach to custody and trading, which can take 12-18 months to implement in our experience.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Strategy and governance

- Engage stakeholders across the business – including portfolio managers, product, strategy and technology leads – to understand how specific digital asset offerings interact with the firm's strategy.
- Determine approaches to build infrastructure for fund tokenisation or digital asset custody. Partner with or acquire a specialist provider or build in-house.
- Determine target funds to pilot tokenisation – we note current interest around money market funds and equity funds.
- Maintain view of partners and competitors as tokenisation pilots progress.

Operations and control functions

- Embed risk and compliance in tokenisation pilots, building knowledge of new/enhanced DLT risks. May reduce time-to-market if pilots mature.
- Enhance capabilities to manage the risks of relationships with service providers supporting digital asset strategy implementation. These include vendor due diligence, scrutiny of ongoing financial and operational resilience and risk management, reputation, and real-time service quality monitoring.
- Enhance and demonstrate capabilities to maintain operational resilience of tokenised funds. E.g. develop and test a business continuity plan, including back-up of critical data on the DLT and client communications strategy in case of disruption.
- Engage regulators as early as possible on planned offerings and before final go/no-go decisions, providing time to build regulatory considerations into design work. Concerning tokenised funds, the investment manager will need to consider the potential need to register with the FCA under the MLRs.

Diversity & Inclusion

Turning up the dial

Impact Areas

Governance · Strategy · Finance · Operations · Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- The FCA and PRA published consultations on D&I and NFM in September 2023. Proposals include requirements for firms to set up D&I strategies and targets and publicly disclose their progress. Collecting sensitive data from employees and showing tangible progress will be a particular challenge.
- The EBA has warned about slow progress on D&I, with only 49% of a sample of 129 EU investment firms having a board diversity policy in place, and only 18% of executive directors and 21% of non-executive directors being female across the sample. National supervisors are expected to act to enforce the requirements more effectively. Firms should also consider compliance with the CSRD which is set to expand D&I disclosures.

WHAT'S HAPPENING THIS YEAR?

- The FCA and PRA have proposed a set of minimum requirements for a range of regulated firms. Larger firms (over 250 employees) would be required to **develop, maintain and publicly disclose D&I strategies, set targets against key demographics and report data across a range of metrics** on an annual basis.
- Firms need to develop their approach to **data collection**, whilst also communicating with employees to understand their concerns and potential barriers to providing the D&I information the regulators expect.
- Firms will welcome the fact that the regulators are expecting them to **develop their own strategy and targets** for progress on their D&I efforts. The high levels of disclosure proposed mean that firms will need to work hard to make progress or face difficult conversations with regulators and other stakeholders.
- Key senior managers such as the Chair of the Board and CEO are **responsible for culture** and D&I will need to be embedded into their responsibilities. This expansion of key roles' prescribed responsibilities needs to be carefully reflected in role objectives, performance and remuneration and incentives practices.
- As part of the CSRD, firms will need to report on the social aspects of their operations by 2025. This will involve disclosing D&I policies and data. This comes against a backdrop of currently low compliance with D&I policy disclosure and setting low D&I targets.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Create a psychologically safe environment for employee disclosures

- Firms may find collecting sensitive D&I data challenging. They will need to develop the right systems and approach for data collection, whilst being open with employees on their concerns and potential barriers for disclosing sensitive data.

Develop NFM clarity for employees

- Firms will need to provide clarity on what constitutes NFM. New requirements on NFM will need to be highlighted in internal policies, employee contracts, remuneration policies and employee handbooks.

Assessment and root cause analysis

- First, firms need to first assess their current D&I policies, targets and metrics. Firms might want to identify key areas of under-representation which should be the focus of targets and improvement going forward.
- To create an effective strategy, firms need to understand D&I across their business. Many firms could improve their data collection – for example, a recent Investment Association survey found that nearly half of firms do not track career advancement or promotion levels across diversity characteristics.
- Ultimately, firms might want to work to understand the root causes of the barriers to D&I progress so far. This analysis could provide valuable insight for the action plan for implementing the D&I strategy and ensuring its effectiveness.

Mind the ESG gap

- In an environment of heavy scrutiny of how investment managers are approaching ESG, firms that make strong public commitments relating to their own D&I should consider how it may be perceived if their portfolio companies have poor D&I credentials.

Other key issues

Prudential regime, T+1 settlement, financial crime

Impact Areas

- Governance
- Strategy
- Finance
- Operations
- Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- Prudential regime: investment management firms should continue to ensure effective implementation of their ICARA process, including more holistic consideration of key thematic and emerging risks.
- T+1 settlement:: the US is moving to T+1 in May 2024, which will put it out of sync with the UK and EU – this will increase the complexity of firms' cross-border operations and FX liquidity needs.
- Financial crime: firms will need to respond to the increasing supervisory scrutiny of their sanctions systems and controls whilst managing the divergence between the UK and EU sanctions regimes.

WHAT'S HAPPENING THIS YEAR?

- Prudential regime: following the FCA's recent publication of its second report on IFPR implementation, there is a particular expectation for firms to improve the credibility of their wind-down planning and risk quantificationarrangements for their ICARA, and ensure effective risk governance, monitoring, challenge and reporting. Also, in H2 2024, the FCA is expected to publish final rules on its proposals to require PIFs to set aside capital for potential redress liabilities at an early stage.
- T+1 settlement: investment managers with exposure to the US will have to complete the T+1 implementation by May 2024. Those operating across jurisdictions with different settlement cycles or across multiple currencies (FX markets settle at T+2), will face increased liquidity risks and costs. There will also be an increased settlement mismatch for fund subscriptions and redemptions, which often settle at T+3. The UK Accelerated Settlement taskforce and ESMA will submit final reports on the costs and benefits of moving to T+1 by the end of 2024.
- Financial crime: in the UK, we expect sanctions systems and controls examinations to be a priority for the FCA in 2024, as set out in its Sanctions Modular Assessment Proactive Programme report. Firms will need to review how they apply the "ownership and control" test in relation to sanctions in light of the Court of Appeal's judgment in the *Mints v National Bank Trust and Bank Okritie* case and the UK Government's subsequent guidance on the applicability of the "ownership and control" test. In the EU, MS continue to strengthen standards ahead of the establishment of AMLA, including stricter AML enforcement, larger AML fines, and requiring identification of management body individuals with AML responsibility.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

Prudential regime

- In view of growing pressure on firms to minimise inefficiencies in key risk processes, systems and controls, firms will continue to seek opportunities to enhance the effectiveness of both the design and delivery of these arrangements.
- Firms should apply a holistic financial resilience and harm mitigation lens to thematic risks e.g. the Duty, operational resilience, sustainability.
- PIFs to quantify their potential redress liabilities and set aside capital resources.

T+1 Settlement

- Investment managers trading US financial instruments will need to prepare to carry out all settlement-related processes at night-time or relocate workers.
- Whilst implementing changes for T+1, firms should assess what more will be needed for any eventual transition to T+0 and consider "no regret" actions now.
- Firms should assess the impact of increased liquidity risks and the cost of hedging additional risk when operating across jurisdictions with different settlement cycles or across multiple currencies.
- Firms should assess the costs and benefits of moving to a shorter settlement cycle for fund subscriptions and redemptions.

Financial crime

- Ahead of the FCA's Sanctions Assessment, firms should test their sanctions screening systems, including for securities, to ensure configuration is adequate.
- Firms should conduct horizon scanning, scenario planning and "lessons learned" from the Russian-Ukraine sanctions to manage sanctions risk more proactively.
- Firms should anticipate administrative and legal challenges from investors or counterparties that find their accounts frozen in relation to sanctions.
- Firms should strengthen their AML, fraud and tax evasion facilitation controls in anticipation of the creation of AMLA and FCA supervisory priorities.

Looking ahead

Future of the UK and EU regulatory framework

Impact Areas

- Governance
- Strategy
- Finance
- Operations
- Control functions (Risk/Compliance/IA)

KEY CHALLENGES

- Non-UK retail funds that are marketed in the UK will need to apply for recognition under the OFR – they should look out for clarification on the rules around value assessments and investor disclosures.
- The EU's retail investment strategy could introduce significant new requirements on value for money and inducements – while the details are not finalised, firms can already consider lessons from the UK's experience.
- The UK is making some significant reforms to bolster its competitiveness – while firms will welcome increased flexibility in some areas, they will have to manage the cost of increased regulatory divergence with the EU.

WHAT'S HAPPENING GOING FORWARD

2024

UK

- New rules on **investment research** in H1
- FCA consultation on amending **AIFMD regime** incl. for non-UCITS retail funds
- Review of **Short Selling Regulation**
- Consultation on **retail disclosure regime**
- HMT to issue **equivalence decisions for non-UK retail funds** under the **OFR**
- Policy statement on **UK MMF resilience** likely

EU

- Final text of **revised AIFMD and UCITS** published in Official Journal (Q1)

2025

UK

- FCA review of **AIFMD regulatory reporting regime**

EU

- Political agreement expected on **EU's retail investment strategy**
- Political agreement expected on **EU's AML regime**

2026

EU

- Deadline for implementing **revised AIFMD and UCITS** rules (expected Q1)

N.B We are also expecting policy developments on the UK Advice-Guidance Boundary review, but the timing is unknown.

KEY ACTIONS FOR INVESTMENT AND WEALTH MANAGERS IN 2024

OFR

- Non-UK retail funds will have to apply for recognition so that they can continue marketing in the UK when the TMPR expires at the end of 2025. The UK government is expected to issue equivalence decisions in 2024 – these could impose additional requirements e.g. potentially value assessments.
- OFR retail funds will need to comply with the new UK retail disclosure regime and the SDR, and to have their financial promotions approved by a UK firm.

Revised AIFMD and UCITS framework

- EU firms will need to review their governance arrangements in view of the new rules on fund liquidity management and delegation, and invest in IT systems to comply with new rules on supervisory and investor reporting.
- UK delegate portfolio managers may need to enhance the MI they provide to EU firms to enable EU firms to demonstrate compliance with the new rules.

EU's retail investment strategy

- While the details are unlikely to be finalised until 2025, firms can expect increased scrutiny of value for money and inducements. Firms can already start considering how this may affect their business model and strategy.

MMFs

- The FCA is proposing a significant increase in the minimum proportion of highly liquid assets that UK MMFs have to hold which is likely to reduce yields for investors – firms will need to consider how to remain attractive to investors.

Managing regulatory divergence

- Firms will need to assess whether to have a single, group-wide compliance or risk approach to dealing with regulations which differ, and whether there are any parts of their cross-border business which become economic as requirements diverge.

Glossary

AFM
Authorised Fund Manager

AIFMD
Alternative Investment Fund Managers Directive

AML
Anti-Money Laundering

AMLA
Anti-Money Laundering Authority

CSA
Common Supervisory Action

CSDDD
Corporate Sustainability Due Diligence Directive

CSRD
Corporate Sustainability Reporting Directive

CTP
Critical Third Party

D&I
Diversity and Inclusion

DC
Defined Contribution

DLT
Distributed Ledger Technology

DORA
Digital Operational Resilience Act

Duty
Consumer Duty

EBA
European Banking Authority

ESG
Environmental, Social and Governance

ESMA
European Securities and Markets Authority

ESRS
European Sustainability Reporting Standards

FCA
Financial Conduct Authority

FINZ
Financial Institution Net-Zero

FMI
Financial Market Infrastructure

FS
Financial Services

FX
Foreign Exchange

HMT
His Majesty's Treasury

IA
Internal Audit

ICARA
Internal Capital Adequacy and Risk Assessment

ICT
Information and Communications Technology

IFPR
Investment Firms Prudential Regime

IOSCO
International Organization of Securities Commissions

ISSB
International Sustainability Standards Board

IT
Information Technology

KPI
Key Performance Indicator

MI
Management Information

MiCAR
Markets in Crypto-Assets Regulation

MiFID II
Markets in Financial Instruments Directive

MLRs
Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

MMF
Money Market Fund

MS
Member State(s)

NAV
Net Asset Value

NFM
Non-Financial Misconduct

OFR
Overseas Funds Regime

PIF
Personal Investment Firm

PRA
Prudential Regulation Authority

SBTi
Science Based Targets initiative

SDR
Sustainability Disclosure Requirements

Glossary

SDS
Sustainability Disclosure Standards

SFDR
Sustainable Finance Disclosures Regulation

TNFD
Taskforce on Nature-related Financial Disclosures

TPP
Third-Party Provider

TPRM
Third-Party Risk Management

TPT
Transition Plan Taskforce

UCITS
Undertakings for Collective Investment in Transferable Securities

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