Global regulations to watch in 2022

Opportunities and challenges
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“Events...events”
Harold Macmillan, UK Prime Minister from 1957-63, may or may not have given that response to a journalist when asked what is most likely to blow governments off course. Regardless of the original circumstances, the remark is still relevant 60 years on. Governments worldwide, including their securities regulators, have in recent years adjusted their priorities a number of times in response to events. In the early 2010s, securities regulators were enacting wide-ranging legislation in response to the financial crisis of 2008. As the new laws were being implemented by the industry, regulators turned their attention to the hope of encouraging economic growth. They were brought up short in 2020 by the global Covid-19 pandemic, leading to legislative enactment delays. With vaccination programmes now well established in many countries, the potential to consider and hopefully reinforce growth has returned.

Moving into 2022, financial services firms will continue to implement the tail end of the post-2008 regulatory programme, but the thematic focus has shifted. Regulations on sustainability and digitalisation have moved to the forefront, as changing global trends have identified a need to enable, control and supervise in both areas. The European Union’s “growth agenda” has led to the creation of the Capital Markets Union “action plan”. Brexit is leading to new regulatory reviews in the UK. In Asia Pacific, opportunities for cross-border investment continue to be explored as economies develop further and populations, in turn, demand a wider range of financial services. Policy makers in the Middle East will remain focused on initiatives that will drive greater diversification of their economies. The change of administration in the USA is bringing with it a change of emphasis in many areas, including regulatory priorities in financial services.

These reforms will create opportunities and challenges. Firms will accordingly need to devote more time to strategic planning for the long-term implications of forward policy priorities, while remaining vigilant in the implementation of known new frameworks. The priorities may have changed, but the volume and pace of new legislation are as high as ever, particularly for those players operating from West to East or vice versa. There are challenges for the regulators too, in managing their own range of activities within the context of globalisation, regulatory arbitrage and geopolitical uncertainty.

In this paper, HSBC’s Securities Services shares its view of some the key global policy priorities and regulations to watch as we move into 2022.
Environmental, social and governance (ESG) regulation goes global

ESG regulation will continue to evolve into 2022, as further focus on environmental, social and governance factors emerges from the pandemic and the resulting economic onslaught of the past year. The economic recovery from the impact of the pandemic presents governments and regulators with an opportunity to reshape policies and frameworks, integrating ESG factors at their core. Also driving the focus is the global effort to meet the ESG targets set by landmark agreements, including the Paris Climate Agreement and the UN Sustainable Development Goals, by 2030. The UN report on climate change released on 9 August 2021 was alarming in its observations and outlook. Global initiatives for sustainability have an immediate priority in preparing for the UN COP 26 conference taking place in Glasgow in November. Regulation will be a mechanism for achieving the specified goals, as defined asset owner obligations and enhanced disclosure requirements reinforce the market impetus driving greater private sector capital into sustainable investments.

ESG in Europe: European Union (EU) regulators have been at the forefront of developing the global ESG regulatory landscape, incorporating ESG requirements into existing EU regulations. ESG disclosure obligations under Level 1 of the Sustainable Finance Disclosure Regulation (SFDR) have applied since 10 March 2021. The EU’s Taxonomy Regulation, scheduled for 1 January 2022 implementation, should increase the reliability of disclosures to identify and measure "environmentally sustainable" activities consistently. The global invested asset ecosystem does not itself yet provide the level of disclosure that allows for precise ESG measurement, and regulated firms may for now need to use their informed judgement in aspects of making disclosures. Issuance of green bonds with ESG credentials is progressing, but demand is creating a greenium (green premium) with reduced yield in some cases.

The United Kingdom has chosen by 2025 to align its environmental disclosure rules for large firms with the Financial Stability Board’s Task Force on Climate-related Financial Disclosures.

ESG in Asia Pacific: Regulators across Asia are creating the framework to bring ESG factors into the investment process. Their initial focus is on climate risk, with action planned into 2022 and beyond.

Hong Kong’s Securities and Futures Commission (SFC) has released requirements on management and disclosure of climate-related risk at asset management (Type 9) licensed corporations (LC). These LCs have investment management discretion in respect of collective investment schemes. The new rules require an appropriate governance framework, incorporation of climate-related risks applicable to an LC’s investment strategies, implementation of risk management procedures, and appropriate disclosures to investors.

Similarly, the Monetary Authority of Singapore (MAS) has released guidelines on environmental risk management for financial institutions (banks, insurers and asset managers). Under the guidelines, asset managers must assess environmental risk factors. In Australia, the Prudential Regulation Authority has outlined its plans concerning climate-related financial risk, assessment of climate change vulnerability, and investment governance. Important coordinated initiatives are progressing, for example in China, where regulators are collaborating with their EU counterparts to develop a "common ground" taxonomy.

ESG in the USA: The Biden administration has focused on ESG, placing climate change policies at the top of its agenda, along with issues relating to social justice, equality, diversity,

1 January 2022

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and human rights. Examples of the change in approach are the USA re-joining the Paris Agreement on climate change on 19 February 2021, and an SEC public statement on 24 February 2021 that it will “focus on climate-related disclosure in public company filings”. The SEC has “an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change”, and seeks public input including “empirical data and other information in support of their comments. Original data from respondents... may assist in assessing the materiality of climate-related disclosures, and the costs and benefits of different regulatory approaches to climate disclosure”.

ESG in the Middle East: In line with client expectations and the new regulatory obligations already described, international asset owners and investors are increasingly developing policies to achieve greater disclosure of the ESG credentials of their investments in the Middle East. Local regulators are progressing on the subject. Helpfully, there can be significant overlap between ESG principles and Sharia-compliant investing.

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16 https://www.jdsupra.com/legalnews/us-financial-firms-should-prepare-for-8251429/
17 https://www.state.gov/the-united-states-officially-rejoins-the-paris-agreement/
Regulators recognise that digitalisation represents an enormous opportunity for financial services and, in turn, for the consumers of those financial services, and the digital revolution has been said to represent the fourth wave of globalisation. For regulators, investor safety is essential, balanced by the need to promote, or at least not stifle, the growth enabled by digital innovation. There is variation in regulatory priorities around the world. New digital services are the product of technology and commercial incentive, so regulators are having to prioritise safety of the consumers’ preferred digital services in each particular market. However, regulatory jurisdiction is a particular concern in the digital world, where data can move instantly across borders. For each regulator, the validity and legitimacy of within perimeter cryptoassets and virtual currencies must be determined in law.

The Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI), International Organisation of Securities Commissions (IOSCO) and the Organisation for Economic Co-operation and Development (OECD) have for some years been scrutinising the impact of digital assets. The Financial Stability Board (FSB) published recommendations for the regulation of ‘global stablecoin’ (GSC) arrangements. Also, the IOSCO gives a helpful description of cryptoassets.

Central Bank Digital Currency (CBDCs) and stablecoin regulation is proceeding widely, but algorithmic and other virtual currencies may potentially be left to operate outside regulators’ rules and investor protection, as indicated in the UK.

Further areas relevant to securities include the use of Distributed Ledger Technology (DLT) within existing structures, for example, custodians and CSDs, data protection, and data storage location, especially Cloud usage. Cybersecurity, data storage and remote access areas that have grown greatly in significance during the pandemic and are receiving attention from regulators. Guidelines from the European Securities and Markets Authority (ESMA) on outsourcing to cloud providers apply from end of 2022, and there is ever-increasing regulatory scrutiny of outsourcing of operations by securities industry firms, especially core and critical operations.

Digital in Europe: The European Union on 24 September 2020 put forward wide-ranging proposal for digital regulation, including the DLT Market Infrastructure Regulation (with pilot regime), the Digital Operational Resilience Act (DORA), and the Markets in Cryptoassets Regulation (MiCA). In addition, the European Central
Bank is proceeding with its plans for a CBDC. We can expect further developments while moving into 2022. There have also been national developments in the EU, notably in Germany and France. In the UK, regulators have put forward initiatives in the areas of cryptoassets, central bank digital currency, and stablecoins. These policy developments will represent an important part of the future compliance programmes of regulated financial institutions and their technology providers.

Digital in Asia Pacific: In Asia Pacific, the cryptocurrency and digital-asset ecosystem has seen rapid growth over recent years and is generating opportunities for novel business models. The Asia-Pacific region is also a hotbed for digital innovation and has a significant cryptocurrency adoption rate among citizens.

Regulators are responding to these developments, for example:

- Regulation of Security Token Offerings (STOs): In Hong Kong, Singapore, Japan and Australia, the usual securities framework can be applied to STOs, if certain conditions are met and regulatory sandboxes are in place. STOs are prohibited in China.

- Regulation of cryptocurrencies: Singapore is creating a legal framework using its Payment Services Act, to provide participants the confidence to operate safely. Hong Kong and Singapore have created new licensing laws requiring regulatory approval before trading is allowed and addressing such matters as anti-money laundering. Japan has set out its own screening and licensing requirements.

- Widespread development of CBDCs, such as in China, South Korea, Japan, and Australia on an Ethereum-based DLT platform.

- The Singaporean and Australian Exchanges’ potential use of DLT to streamline or replace equities post-trade processes.

Digital in the Middle East: In the Middle East, amongst other projects, the UAE and Saudi Arabia central banks have released a joint report on their dual-issued CBDC trial (project Aber), which tested the viability of a shared digital currency between the nations, with its results positively affirming the capability of blockchain technology.

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Regulators are requiring the approximately USD350 trillion of financial products (e.g., derivatives, credit instruments, securitisations) that use LIBOR (London Interbank Offered Rate) and other IBORs as reference rates to move to alternative interest rates such as ‘near Risk-Free Rates’ (RFRs). The regulatory imperative reflects the decline in IBOR usage in recent years.

On 5 March 2021, the Financial Conduct Authority (FCA) announced the cessation immediately after 31 December 2021 for all LIBOR settings, except for some USD rates, immediately after 30 June 2023. The final spread adjustments for each combination of currency and tenor have been published by Bloomberg. Further detail on the use of fallback rates is available through various sources.

Market participants whose existing transactions extend beyond 2021 will need to decide whether to replace the referenced IBOR with the RFR ahead of the former’s discontinuation, or, where possible, to use “fall-back provisions” that determine the replacement of the referenced IBOR with the alternative benchmark. Investment firms will also need to begin using new benchmarks if their performance targets are based on the old IBOR rates. There is particular UK regulator and industry focus on the process (and removal of bottlenecks) for obtaining investor consent for changes in benchmark rates on Floating Rate Notes (FRNs) in time for the 2021 deadline.
Europe: navigating two rule books (EU/UK)

European Securities Settlement
The EU’s Central Securities Depositories Regulation (CSDR) has established a standardised framework for the supervision of European Central Securities Depositories (CSDs), and a pan-EU T+2 settlement cycle. Importantly, the last phase of CSDR aims to introduce a new European settlement discipline model for settlements at EEA CSDs, now scheduled for 1 February 2022. The EU Commission’s CSDR Review Report was published on 1 July 2021. Per the report, subject to an impact assessment, the Commission will consider proposing a refit to elements of CSDR more broadly, and to the new settlement discipline regime specifically around mandatory buy-ins, based on feedback from the industry.

In June 2020, the UK Government confirmed that it will not implement the CSDR settlement discipline rules within their post-Brexit rule book. The UK government has indicated that any future legislative changes would be developed through consultation with industry to ensure any settlement discipline regime is appropriate for the UK market.

European (and global) derivatives
On 4 May 2020 ESMA (following BCBS-IOSCO) postponed by one year the application of the EMIR initial margin rules for in-scope counterparties, so the new dates are:
- 1 September 2021: Initial margin requirement for organisations with derivatives swaps notional outstanding > €50bn
- 1 September 2022: Initial margin requirement for organisations with derivatives swaps notional outstanding > €8bn.

Next generation Alternative Investment Fund Managers Directive (“AIFMD”)
Responses to the EU Commission’s AIFMD Review consultation were received by 29 January 2021. The AIFMD Review covers many topics and broadly signals the direction of travel regulators are minded to take in order to improve AIFMD. Firms will be closely tracking progress into 2022. Key topics covered include AIFM Licence, Fund Marketing and Distribution, Investor Protection Measures, Third Country AIFMs and AIFs, Provisions to Maintain Financial Stability, Investment in Private Companies, and ESG.

58 https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS009
Packaged Retail Investment and Insurance-Based Products (PRIIPs)

Asset managers will have to prepare PRIIPs Key Information Documents (KID) for Undertakings for the Collective Investment in Transferable Securities (UCITS) funds, as the PRIIPs KID for UCITS exemption is scheduled to expire at the end of 2021. However, in a letter to the European Parliament and the Council on 10 May 2021, Commissioner Mairead McGuinness stated that the European Commission will move the end of the exemption for UCITS funds and the application of the new RTS requirements to 1 July 2022. The European Commission has stated that they want to avoid the publishing of both PRIIPs KID and UCITS KIID for retail investors of UCITS funds after this deadline.

In the UK, HM Treasury announced on 1 June 2021 that under UK law the current exemption from the requirements of the PRIIPs Regulation for UCITS funds distributed in the UK will be extended by five years to 31 December 2026.

In the context of non-EU funds sold in the EU, it is notable that the Cayman Islands has confirmed that it will establish a public registry of beneficial ownership in 2023, which will help the jurisdiction comply with internationally accepted standards and regional regulations such as the EU’s fifth AML Directive.

Switzerland

In Switzerland, the implementation of the Swiss Financial Institutions Act (FinIA) and Financial Services Act (FinSA) continues, with various deadlines throughout 2021, and beyond in some cases. Scope largely covers organisations and individuals outside Switzerland selling or providing services to Swiss entities or entities within Switzerland. Requirements include licensing, registration with Swiss authorities, affiliation with a Swiss ombudsman, and adoption of new conduct rules.

Shareholder Transparency

The second phase of the Shareholder Rights Directive II (SRD II) has applied since 3 September 2020. Firms will be monitoring progress of the EU Capital Markets Union Action Plan action 12, which states that the Commission will consider introducing an EU definition of “shareholder”, a key item for definition under SRD II.

Beyond the Pandemic and Back to the Growth Agenda

The EU’s latest Capital Markets Union ("CMU") Action Plan was published on 24 September 2020. The aim of CMU is to improve capital flow across the EU so that it can benefit consumers, investors and companies, regardless of where they are located. The action plan identifies three objectives and 16 actions. Key growth-oriented actions include:

- EU Single Access Point (ESAP) for financial and sustainability data;
- Simplifying listing rules;
- Further development of securitisation;
- Development of European Long-Term Investment Funds (ELTIFs);
- More standardised withholding tax procedures;
- Harmonising non-bank insolvency law and procedures, where feasible;
- Definition of shareholder (reflecting Shareholder Rights Directive II concerns);
- Improved cross-border settlement within the EU.

Firms can expect progress on CMU until 2023 and beyond.

Brexit

The United Kingdom left the EU ("Brexit") on 31 January 2020. The EU/UK transition period then ended on 31 December 2020, following completion of a Trade and Cooperation Agreement (TCA). On 1 July 2021, the UK Chancellor of the Exchequer said within a speech, "... our ambition had been to reach a comprehensive set of mutual decisions on financial services equivalence. That has not happened...", indicating perhaps that market participants should be cautious on EU/UK financial services equivalence prospects. EU temporary equivalence for UK central counterparties continues until 30 June 2022.

From the UK side, there is UK equivalence for EEA states in a number of areas including EMIR, Capital Requirements Regulation, Solvency II and CSDR. UK firms (under UK law) may continue to trade at EEA trading venues. Also, UK policy makers have begun to communicate areas where regulations will be designed based on what is considered appropriate for UK financial services, including strengthened securities settlement discipline rules, Solvency II rules based on the specifics of the UK insurance market, measures expected to increase the local domiciliation of investment funds, ESG regulations designed to prevent greenwashing, and introduction of a new or updated prudential regime for investment firms and banks, including Basel III.

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Policy makers in the Asia Pacific region remain focused on developing robust financial services as economies continue to mature. The pipeline of regulatory change continues to provide opportunities for international firms to reach new markets based on policies that are locally relevant but also familiar based on best practices seen internationally.

Digital and ESG are key planks of policy priorities, as already mentioned.

Regulators are also focused on transparency, with expectations of increased reporting of the activities of asset managers and insurance companies. Investor protection is high on the agenda, as is good conduct and corporate governance practices of regulated firms.

Hong Kong’s SFC is working to revamp the Code on Pooled Retirement Funds and Occupational Retirement Schemes (Amendment) Bill with an aim to modernise and strengthen scheme member protections along the lines of the standards of the Code on Unit Trusts and Mutual Funds, which governs unit trusts. The MPFA in Hong Kong is working to implement a major infrastructure program, eMPF, which aims to standardize, streamline and automate existing member scheme administration processes. The SFC plans to bring trustees and custodians of SFC-authorised schemes under its regulatory remit by introducing a new licensing regime for such activities.

In Singapore, MAS is developing a fund manager regulatory reporting regime with implementation expected in 2022. The industry has already implemented comprehensive fund manager regulatory reporting in Hong Kong, Europe (AIFMD Annex IV) and the USA (Form PF) so the task will be familiar. It is expected that the data requirements will encompass fund holdings and investor dealing data, which are to be submitted on a daily basis. We look forward to further details of the regime to be announced by MAS.

Broader efforts continue in the region to encourage local fund manufacturing with good success reported for both retail and private Singapore variable capital company (VCC) investment funds. Hong Kong is similarly focused on developing its corporate and limited partnership fund offerings.

Emerging from the pandemic it is hard to see the Asia Region Fund Passport (ARFP) or similar cross-border distribution schemes picking up widespread near-term adoption. However, distribution opportunities with mainland China remain a key focus for asset managers.

We can look forward to the potential launch of ETF (exchange traded fund) Connect between Shenzhen and Hong Kong. The recently launched Wealth Connect in the Greater Bay Area (GBA) initiative will facilitate investor access to cross-border investment products within the region.

International asset managers will continue to closely monitor policy developments that permit the establishment of subsidiaries in mainland China.

Asia Pacific: markets continue to evolve
Middle East: developing financial markets

In the Middle East, jurisdictions are opening their economies to foreign institutional investors, and seeking to update their post-trade infrastructures and supporting legal structures. The UAE’s Securities and Commodities Authority (SCA) and Saudi Arabia’s Capital Market Authority (CMA) have both executed their plans to launch CCPs in 2020. In the UAE, the Dubai Financial Market (DFM) launched two new subsidiaries in 2020, Dubai Clear (CCP for equity clearing) and Dubai CSD. A similar step is also expected from the other UAE market, the Abu Dhabi Exchange (ADX). In 2020, Saudi Arabia launched a new market and CCP for derivatives as one of the Financial Sector Development Program’s (FSDP) key initiatives under the Saudi Vision 2030 programme. Kuwait had also confirmed that it will launch a cash CCP shortly. The Kuwait Clearing Company (KCC) will be split into two legal entities to operate as Kuwait Clearing House (CCP and Securities Settlement facility) and Kuwait Central Securities Depository. Depending on their activities, participants will be required to become Exchange members, Clearing House members (Direct Clearing member or General Clearing member) and CSD members. The current financial collateral system will be replaced by a default fund, and participants will be required to contribute.

Final thoughts

With reference once more to Harold Macmillan at the beginning of this paper, the subject matter may change, but the principle of governments responding to events stays the same. Climate change, digital innovation and cyber protection have moved to the forefront of regulators’ minds, where new legislation will be enacted globally to ensure that the system will hold in the face of the new disruptors and risks to the planet. Policy will focus on how financial markets can safely enable economic growth in a post-pandemic world. In the here and now, we can safely predict that 2022 will bring more regulation and with it more opportunities and challenges for regulated financial services.
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