Report

New in RegTech:

ESG requirements keep coming; EU investor portal moves forward; Position limits; Europe: update on ECB reporting and MMFR

by:

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ESG developments continue at a pace

Commensurate with the urgency of the global climate crisis, ESG continues to occupy much of the regulatory calendar.

In the EU, ESMA recently updated its proposed guidelines for fund names using sustainability terms, expected to be approved and published in Q2 2024 (subject to progress on completion of AIFMD and UCITS revised texts to be considered in those guidelines). The guidelines would enter into effect three months later, at which point managers of new funds would be expected to comply with them, and managers of current funds six months after that.

Meanwhile progress has been seen on the European Commission's proposed regime for ESG ratings providers, with the Council in December having finalized its negotiating position on that proposal, ahead of inter-institutional talks to begin this month of January.

Staying with the EU, the Corporate Sustainability Due Diligence Directive (CSDDD) has taken the next step, with the Parliament and Council reaching a provisional deal on the regime that had been proposed by the Commission in 2022. Notably, the new deal excludes financial services from the scope of the law (although it provides for possible future inclusion after an impact assessment).

In the UK, the FCA recently announced the launch of a voluntary Code of Conduct for ESG Ratings and Data Product Providers produced by the two organizations it appointed for that purpose, the ICMA and the IRSG. Grounded in the recommendations of IOSCO, the Code of Conduct is intended for adoption globally, and its signatories will appear at ICMA's dedicated web page. The suggested implementation period is 6 months for ESG ratings providers and 12 months for ESG data providers. (Meanwhile on the regulatory front, HM Treasury has yet to announce the result of its consultation on regulating ESG ratings providers which concluded last Summer.)

On a global level, the Task-Force on Climate-Related Disclosures (TCFD) has disbanded, having declared its remit fulfilled and paved the way for the SASB standards which incorporate the TCFD's recommendations. At the COP28 climate summit which wrapped up in December, the SASB standards (which have just come into effect for reporting periods starting on 1 January 2024) received the support of more than 400 organizations from over 60 jurisdictions.

"With its strong focus on international consistency, this industry-owned code will play a key role in increasing transparency and trust in the ESG data and ratings market. We encourage all ESG data and ratings providers to engage with and sign up to the code."

- Sacha Sadann FCA Director of Environmental, Social and Governance"

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A long and winding road: the European Single Access Point edges closer to reality

The European Single Access Point (ESAP), a digital platform that investors will be able to consult for financial and non-financial information about EU companies and financial products, took another step toward fruition with recent adoption of the ESAP Regulation. As an important component of the European Commission's "capital markets union" — in fact the very first objective, according to its 2020 CMU action plan — ESAP is in fact just the latest incarnation of a 15 years-long push by the EU to enable investor access to centralized issuer data (see for example plans for a "Central Access Point", and a "European Electronic Access Point").

The ESAP portal is to provide investors with free, centralized access to financial and sustainability information made public by EU companies large and small (no additional reporting obligations are being imposed on them, but they may voluntarily submit additional information for ESAP). While the ESAP Regulation enters into force on 9 January 2024, the portal's development will take another few years, with ESMA required to establish and operate it by 10 July 2027. In its latest Work Programme, ESMA affirms that in 2024 it will produce technical standards and continue work on the IT infrastructure needed for ESAP. (For a broader look at ESMA's data strategy, see the five year plan it published last June.)

Existing EU financial laws will incorporate ESAP, according to an accompanying omnibus Directive and Regulation that amend those regimes accordingly. These amendments essentially require that EU Member States and reporting parties ensure that the information reportable under those regimes is also made accessible to the relevant collection bodies for ESAP purposes. This would need to happen by these dates, for the following regimes:

10 July 2026 (note that this is before ESMA's deadline to establish and operate ESAP in 2027)

- the Transparency Directive
- the Short Selling Regulation
- the Prospectus Regulation

10 January 2028

- the UCITS Directive
- the Benchmarks Regulation
- the Accounting Directive
- the Market Abuse Regulation
- PRIIPs
- SFDR
- the Credit Rating Agencies Regulation
- the EuSEF Regulation
- the EuVECA Regulation
- the PEPP Regulation

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10 January 2030

- Solvency II
- AIFMD
- MiFID II
- the Insurance Distribution Directive
- IORP II
- the Investment Firms Directive
- the Financial Conglomerates Directive
- the Takeover Directive
- the Audit Directive
- CRD IV
- BRRD
- the Covered Bonds Directive
- MiFIR
- MMFR
- SFTR
- the Audit Regulation
- the Capital Requirements Regulation
- the ELTIF Regulation
- the Green Bond Regulation
- the Investment Firms Regulation
- MiCAR

The ESAP Regulation requires ESMA to enable the portal with functions such as an API, a search tool in all EU languages, downloading of data, and alerts to users when new information appears. These aspects must be implemented according to staggered deadline dates, the last of which is 10 January 2030.

While the ESAP data will be free of charge generally speaking, ESMA will have the right to charge fees for specific services involving high maintenance costs or large volumes of information (with the fee structure being viewable on the ESAP portal).

"ESAP is a critical project for ESMA, which aims to provide free, user friendly, centralised and digital access to financial and ESG information made public by European companies."

- ESMA, 2024 Annual Work Programme

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Position limits: recent and upcoming changes globally

In our November and December editions we covered significant changes to "threshold disclosure" rules coming into effect in the U.S. Another important aspect of investment monitoring and compliance, particularly for holders of derivatives, are the maximum amounts they may hold in those positions. Investors have had to adjust to major regulators and exchanges either modifying their position limits regime in 2023 or preparing to do so for 2024.

To support the development of Hong Kong's derivatives market, HKEx implemented enhancements to its position limits, which took effect on 22 December 2023. The main changes are as follows:

- A 5-tier position limit model now applies to Single Stock Options and Single Stock Futures contracts
- Removal of additional position limits that applied to Hang Seng Index and Hang Seng China Enterprise Index mini derivatives contracts
- Increase of position limits for selected CNH contracts

More details are available on the HKCC, HKFE and SEHK circulars.

Earlier in April 2023, ICE Futures Europe Guidance on Exchange Position, Expiry and Delivery Limits and Accountability Levels. Notable are the new delivery limits added for soft commodities, which establish minimum and the maximum delivery levels.

In the UK, following Brexit portions of EU law were carried over to UK national law, the so-called "retained EU law". But as the UK continues to distance itself, it is reviewing its secondary markets structure, to include a reform of its commodity derivatives regulatory framework. On 4 December 2023, the FCA published a consultation, closing on 16 February 2024, which covers:

- he setting of position limits by trading venues instead of regulators
- Position limits applying only to certain commodity derivatives contracts characterized as "critical"
- Accountability thresholds and access to additional information to enhance position management controls and reporting
- New position limit exemptions
- Changes to the ancillary activity exemption

"We are committed to introducing market microstructure enhancements to continue to boost the vibrancy and attractiveness of our markets. We are therefore delighted to implement these changes to our derivatives market position limits, providing investors with more capacity and greater flexibility, allowing them to better manage their market exposure while ensuring proper risk controls."

- Wilfred Yiu, HKEX Co-Chief Operating Officer and Head of Equities

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European funds face new requirements under ECB reporting and MMFR

Under the European Central Bank's Regulation on investment fund statistics of 2013, investment funds in the euro area have been required to report certain statistics in order to provide the ECB with a comprehensive view of the industry's soundness for policy-making purposes. Since then, total assets of euro area investment funds have increased from €8 trillion to €17 trillion. Recently the ECB proposed to recast the Regulation, with a public consultation open until 12 February 2024.

Under the proposal, investment funds would generally be required to report monthly instead of quarterly, as well as provide additional information on income and fees, securities without public identification codes and the classification of funds. As the ECB notes in its FAQs, investment funds already reporting such additional information to national central banks or NCAs should not see their reporting processes greatly impacted by the recast Regulation.

Expected to enter into force in early 2024, the recast Regulation as proposed would impose the additional reporting requirements starting with the June 2025 reference period.

Meanwhile money market fund managers should take note that ESMA recently updated its parameters for MMF stress testing for 2023, citing the prevailing environment of low growth, inflation and higher interest rates as justifying the new risk parameters. (In the Final Report, the modified guidelines are shown in red text in Annex II on pages 24-66.) Once the new guidelines are translated and published on ESMA's website, they will apply after two months, after which managers will need to report to NCAs under the new parameters with their quarterly reports (under Article 37 of MMFR).

"With respect to the 2023 update of section 5 of the Guidelines, the shocks have been calibrated to be severe, consistent with the uncertainty deriving from the economic consequences of a re-intensification or prolongation of geopolitical tensions."

- ESMA Final Report - Guidelines on stress test scenarios under the MMF Regulation

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