

Financial institutions and fintechs: The UK regulatory top ten watch list for 2022

In brief

As we, with any luck, finally emerge from the shadow of the pandemic in 2022 (albeit more slowly than hoped), regulators and policymakers have left emergency measures behind and returned to their reform agendas. In this piece we set out our top ten UK developments for financial institutions and fintechs to watch in 2022.

1. Embedding good culture

Embedding good culture remains central to the FCA's supervisory priorities, and we expect the regulator to intensify its efforts to hold firms to account for their culture in 2022. The FCA will be looking for assurances from firms that the move to more permanent hybrid working arrangements arising from and enduring beyond the pandemic does not lead to isolation, fewer avenues to speak up, and a lack of control and oversight. Senior management are expected to identify and mitigate the risks that emerge. Given that whistleblowing is also a hot topic for the FCA, it would not be surprising to see the regulator focus on senior management responsibility in this space.

The regulator sees diversity and inclusion (D&I) as integral to culture, critical to both consumer protection and well-functioning markets. As part of embedding good firm culture, the FCA expects firms to consider whether they are sufficiently diverse and inclusive to meet their customers' needs. The FCA considers D&I to be a regulatory issue: firms should expect the FCA to start asking much stronger questions about D&I at senior levels when considering a firm's culture, and to wrap those questions into whether a firm is complying with its obligations to treat customers, especially vulnerable customers, fairly. Firms should be asking themselves whether their management team is diverse enough to provide adequate challenge and create the right environment in which people of all backgrounds can speak up. Firms should also review their approach to vulnerable customers, and reflect on whether they are adequately incorporating diverse, representative considerations in designing their response through product design, customer service and communications.

Firms should keep an eye on a number of regulatory initiatives which are underway: the FCA is working on a joint approach with the PRA on D&I in financial services with a consultation and policy statement to come in 2022, and may look to include D&I more formally in its supervisory processes by adding a sixth question on D&I to the 5 Conduct Questions programme. Although enforcement risk arising from D&I rule breaches will probably not crystallise until after 2022, the FCA may in the interim use the Principles for Businesses and the conduct rules for senior management to ensure firms are approaching D&I appropriately.

For more on this topic, please see our related [blog post](#).

2. Shifting retail expectations - the new Consumer Duty

The FCA's focus on preventing customer harm has come into sharp relief in light of the effects of the pandemic, with broad thematic work taking place across the investments, insurance, mortgages and credit markets to ensure fair pricing and fair

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treatment of customers. One of the headline developments in 2021 was the FCA's proposal for a new Consumer Duty, which has the potential to create a paradigm shift in the regulator's expectations of firms in retail markets. The FCA's first consultation closed at the end of July 2021, and a second consultation setting out more developed proposals for rules and guidance was launched in December 2021; final rules are expected by the end of July 2022 to be implemented by 30 April 2023.

The Consumer Duty is proposed as a package of measures: a new Consumer Principle that provides an overarching standard of conduct, supported by a set of Cross-cutting Rules and Four Outcomes that set clear expectations for firms' cultures and behaviours. Under the proposed Consumer Duty, firms would need to ensure that their products and services are fit for purpose and offer fair value, and that their communications and customer service enable consumers to make and act on well-informed decisions.

The period proposed by the FCA between final rules and implementation – nine months – does not leave firms with a great deal of time to prepare and implement necessary changes. During the second half of 2022 and into 2023, firms will need to ensure that they grasp and understand the Consumer Duty; perform gap analysis on their policies and processes; make relevant adjustments through change projects on product and service design, price and value, customer support and so on; train their staff on the new requirements; design and implement any required IT system changes; and establish processes to monitor and test consumer outcomes. Additionally, during this time period, firms are expected to review their products and services, and if needed update contractual terms and conditions in preparation for compliance with the Consumer Duty's obligations.

For more on this topic, please see our related [client alert](#).

3. Defining the boundaries of BNPL regulation

Alongside shifting regulatory expectations on retail conduct at a high level, the UK government is also taking specific action in sectors where it sees a risk of consumer detriment. In October 2021, HM Treasury published its much-anticipated consultation on the regulation of buy-now-pay-later (BNPL) products. The Treasury proposes to bring BNPL lending within the regulatory perimeter; although the consultation does not provide specific guidance or a firm indication as to the perimeter's boundaries, the proposed regime is lighter-touch than mainstream credit regulation, with most Consumer Credit Act formalities expected to be disapplied. For the merchant community, the consultation proposes that the BNPL regulatory framework include an exemption so that the broking of BNPL credit by a merchant would not lead to a requirement that the merchant is subject to regulation as a credit broker. However, the Treasury has not settled on the precise scope of the to-be-regulated BNPL market. For lenders, it will be important to understand the regulatory position of merchants including, for example, how this may affect financial promotions and whether lenders might need to be involved in approving merchants' promotions of BNPL products if merchants do not ultimately require their own licence or authorisation as a credit broker.

The consultation closed in early January 2022, with further consultations expected to follow on the more specific details of the regime from both the Treasury and, presumably, the FCA as it seeks to tailor its consumer credit rules to BNPL products. While it is unlikely that the final BNPL regulatory regime will apply before the end of 2022 or into 2023, it is clear from the consultation that the Treasury remains open-minded as to how its proposals should be taken forward, giving the industry an opportunity to shape the future application of the regulatory regime.

For more on this topic, please see our related [client alert](#).

4. Bringing crypto within the regulatory perimeter

Regulators continue to grapple with finding balance between fostering innovation and competition, and seeking to ensure customer and market protection against the risks of increased use of technology. Against this backdrop, the cryptoasset market continues to grow, accompanied by ever greater levels of regulatory scrutiny, and both the UK and the EU are set to expand their regulatory perimeters to include cryptoassets.

The Treasury issued a consultation in January 2021 on a new regulatory regime for cryptoassets, which will significantly expand the regulatory perimeter and impose new obligations and requirements on cryptoasset businesses. Drawn from existing payments regulation, the proposed regime will require authorisation and compliance with regulatory obligations for firms issuing or providing services in relation to stablecoins.

Although the Treasury did not indicate a specific target date by which it will respond or set out legislative measures, the Financial Stability Board's roadmap to enhance cross-border payments targets the establishment of national regulatory frameworks on stablecoins by July 2022, and it is likely that the Treasury's response will be published in 2022.



Given the cross-border nature of the crypto industry, UK firms and fintechs should also keep a watching brief on parallel developments in the EU. The new regulatory framework for cryptoassets, set out in the European Commission's proposed Regulation on Markets in Cryptoassets (MiCA), would establish the first EU regulatory regime for cryptoasset providers and hold them to a similar regulatory standard as that imposed on investment firms. Trilogue negotiations are set to continue in 2022.

For more on this topic, please see our related [client alert](#).

In the meantime, the Treasury confirmed on 18 January 2022 that it will expand the perimeter of the financial promotions regime to include "qualifying cryptoassets", with implementing legislation still to be published. The Treasury proposes to define the scope of "qualifying cryptoasset" as any cryptographically secured digital representation of value or contractual rights which is fungible and transferable (though this definition is still provisional and under development), aligning with the proposals in its stablecoin consultation. On 19 January 2022 the FCA launched a consultation on rules for cryptoasset promotions as part of its consultation on strengthening the financial promotions rules for high risk investments. A six month transition period will apply from finalisation of both the financial promotions regime extension and the FCA's rules.

The extension of the financial promotions regime to cryptoassets will have a significant impact on the sector. Many cryptoasset firms are unauthorised and will therefore need their promotions approved by an authorised firm under the new financial promotions gateway, once implemented (about which see more [below](#)). However, as cryptoassets currently sit outside the financial promotions perimeter, it is likely that there will be only a limited number of authorised firms with sufficient competence and expertise to approve cryptoasset financial promotions when the gateway and financial promotion rules take effect. Firms in the crypto industry will need to carefully prepare well in advance of the financial promotions regime extension.

5. Reforming the regulatory approach to AML

Both the UK and the EU are looking to reform their regulatory approaches to anti-money laundering (AML). The Treasury recently issued a call for evidence on the review of the UK's AML framework and a consultation on amendments to the UK's AML regulations. The call for evidence supports the Treasury's review into the overall effectiveness of the regime, while the consultation proposes certain changes to regulation to meet current FATF standards, including implementing the travel rule for cryptoasset transfers. The outcome of the review is expected in mid-2022.

In the EU, the European Commission's package of proposals will create an EU-wide AML supervisory authority, establish a new directly applicable single rulebook, and extend the scope and requirements of the regime including, significantly, to all cryptoasset service providers. While UK firms without an EU nexus will not be caught by the direct application of the proposals, UK firms with EU parent undertakings should expect to comply the proposed single rulebook's expanded group-wide requirements. The proposals are expected to be adopted in 2022.

Financial crime also remains high on the FCA's enforcement agenda: several of the largest fines imposed by the FCA since the start of 2019 have related to financial crime breaches, and the first successful criminal prosecution under the Money Laundering Regulations has just concluded. We can expect this trend to continue in 2022, with the regulator particularly focused on the intent, design and outcome of firms' AML systems and controls. Mark Steward, the FCA's Executive Director of Enforcement and Market Oversight, has noted that AML systems and controls should be "purposeful" - that is, they should focus "explicitly on the activating purpose and function of those controls, to ensure the system is not just a bureaucratic process and to ensure it cannot be gamed". This is redolent of Julia Hogget's exhortation to the industry in 2017 that effective compliance with the Market Abuse Regulation is a "state of mind" - that critical thinking and purposefulness must underpin systems and controls to be effective and compliant.

For more on this topic, please see our related [client alert](#).

6. Tightening the appointed representatives regime

We may see a significant tightening of the appointed representatives (AR) regime in 2022, following an increase in supervisory scrutiny by the FCA. In late 2021, both the Treasury and the FCA published papers on possible reforms to the AR regime. These papers propose significant, wide-ranging changes that have the potential to seriously impact the way that AR arrangements operate, and the burdens placed on principals in particular. The FCA's proposed changes would require principals to provide additional and more timely information on their ARs and how these are overseen, and clarify and strengthen the responsibilities and expectations of principals. The Treasury is considering amending the scope of the AR regime to specify new conditions to be met by principals and ARs (and possibly a "principal permission" gateway), place more direct regulatory obligations on ARs, and expand the role of the Financial Ombudsman Service to include complaints involving ARs. Responses to both papers are due by 3



March 2022. The FCA is expected to issue final rules in the first half of 2022; transitional periods are expected to apply for certain proposed rules.

These proposals are designed to make the AR regime more robust from a compliance perspective, and a consequence of that may be increased barriers to entry for market participants considering the AR regime as a viable business model. As set out in its 2021/22 Business Plan and 2020/21 Perimeter Report, the FCA is already intensifying scrutiny for all principals seeking permissions at the authorisation gateway – the FCA notes in its cost benefit analysis that in a small pilot of a more enhanced approach, 65% of new principals have either withdrawn or the FCA has been minded to refuse their applications. Should the Treasury proceed with a new "principal permission" gateway, these barriers to entry will increase further.

In addition to the specific changes proposed, the FCA is also seeking feedback on potential harms arising from the use of the regulatory hosting model in the investment management sector, including specifically the "Host AIFM" model. Firms using these arrangements should prepare themselves for the possibility that the Treasury and the FCA will seek to exert further supervisory oversight of regulatory hosting arrangements, including potential restrictions or limitations on the use of the model.

For more on this topic, please see our related [client alert](#).

7. Preparing for the financial promotions gateway

Compliance with regulatory requirements regarding the approval of financial promotions has been a recent supervisory concern for the FCA, especially in circumstances where the products being marketed are complex and targeted at the retail market, and the FCA has issued a number of letters and publications setting out concerns and guidance for authorised firms approving financial promotions. In that context, the Treasury confirmed in June 2021 that it will take forward legislation to introduce a gateway for the approval of financial promotions of unauthorised persons. Once the gateway is in place, only firms which have successfully applied to the FCA to approve financial promotions will be permitted to approve the financial promotions of unauthorised persons.

The Treasury's confirmation that it will exempt from the gateway principals approving financial promotions for their ARs in relation to regulated activities for which the principal has agreed to accept responsibility will be welcome news for sectors which more heavily rely on "regulatory umbrella" arrangements, and a relief to the industry that the Treasury has foreclosed the financial promotions approval regime as an avenue for the FCA to exert tighter regulatory supervision, especially in light of the reforms proposed to the AR regime. However, areas of uncertainty remain; for example, it is unclear how the FCA will undertake its assessments of suitability and competence to approve financial promotions, and what this will require applicant firms to demonstrate in practice. On this aspect, at least, we do now have a sense of the regulator's direction of travel: as part of its 19 January 2022 consultation on strengthening the financial promotions rules for high risk investments, the FCA proposes to develop a robust regime to complement the gateway once implemented. This includes a new date stamp for approved promotions and a new competence and expertise self-assessment requirement for firms communicating or approving financial promotions, an ongoing active monitoring requirement for firms approving promotions, and the extension of existing conflicts of interest obligations to prevent anti-competitive behaviour (especially in the cryptoassets market).

The gateway is proposed to be operational by March 2023, with further legislative and regulatory changes to be proposed in preparation. Firms intending to proceed through the gateway should prepare to review their processes and procedures while we await those changes.

For more on this topic, please see our related [client alert](#).

8. Operational resilience – counting down to application

Resilience remains a focus of the FCA, PRA and the Bank of England for all firms and financial market infrastructure providers. The move to remote working during the pandemic, as well as the strain placed on, for example, some trading platforms by high trading volumes in volatile market conditions during 2020 and early 2021, has only served to highlight the importance of this topic. Operational resilience remains an important cross-cutting focus, with final rules from the FCA and PRA on operational resilience requirements to be implemented in 2022. These final rules will be a step change in regulation imposing key new requirements on setting impact tolerances, engaging in scenario testing and self-assessment, and establishing robust related governance arrangements. The regulators also intend to issue a discussion paper on the oversight of critical third parties in 2022.

Operational resilience risk posed by third-party service and cloud-computing providers are expected to be particular areas of post-pandemic supervisory focus. Both the Bank of England and the European Central Bank are interested in the risks posed by supply



chains in financial services, the change management risk following the rapid shift to cloud based services, and senior management responsibility and accountability in relation to management of these risks.

With the UK regulators' operational resilience rules taking effect in 2022, this could also be an area to watch for enforcement risk later in the year.

9. Ramping up ESG regulation (and enforcement?)

The UK government's commitment to meet its net zero target by 2050 has spawned a number of initiatives, in particular the issuance of its first Sovereign Green Bond in September 2021, the introduction of new environmental disclosure standards, climate-related financial disclosures applicable to nearly all financial services market participants becoming mandatory by 2025, and the development of a UK Green Taxonomy in 2022. The FCA also published a discussion paper in 2021 on sustainable labelling, with policy proposals expected for consultation in Q2 2022.

Given the proliferation of sustainability-related regulatory initiatives among the regulators and international standard setters, together with pressure from institutional investors to assign a higher standard of sustainability to financial products, firms should remain cautious and alert to potential conflicts when embedding compliance with regulatory expectations. The extent to which the UK's regulatory and legislative developments — in particular the UK Green Taxonomy — will diverge from the EU's regime remains to be seen. However, the government has been clear that it intends to draw on EU standards while adapting them, if deemed necessary, for the UK market.

The FCA seems keen to forge a reputation as a greenwashing enforcer, to sit alongside the UK government's intentions to lead the market in sustainable finance and regulation. While we await formal enforcement outcomes, Sacha Sadan, FCA ESG Director, indicated during COP26 that possible ESG enforcement action might already be underway, and did not rule out using enforcement to combat greenwashing.

More broadly, climate-related litigation risk is becoming a real prospect. For example, the Network for Greening the Financial System recently flagged the *ClientEarth v Banque Nationale de Belgique* (NBB) case, in which ClientEarth initiated proceedings for injunctive relief against NBB before the Tribunal of First Instance in Brussels. This case is of interest as it appears to be the first case where proceedings were brought against a central bank as a defendant in climate-related litigation.

10. Increasing divergence and the Future Regulatory Framework Review

Last but by no means least, we turn to the wider regulatory picture in the UK. In 2022, we expect to see further significant work being put into developing the architecture and perimeter of the UK's financial services regulatory framework as we move forward post-Brexit. The UK government has been laying out its ambitions for the future of UK financial services regulation, setting its priorities for a realigned approach to regulation as sustainability, innovation and openness.

As part of this realignment, in November 2021 HM Treasury published a consultation proposing significant reforms to the way that financial services are regulated in the UK. The consultation sets out a series of proposals to deliver the intended outcomes of the Future Regulatory Framework (FRF) Review and to reflect the UK's position outside the EU. While the Treasury intends to maintain the FSMA-based model of regulation with the FCA and PRA as twin peaks regulators, proposed reform measures include changes to the regulators' statutory objectives and enhanced mechanisms for accountability, scrutiny and oversight of the regulators by Parliament, the Treasury and stakeholders. The consultation also sets out how the government intends to return responsibility for designing and implementing regulatory requirements to the UK regulators, in what it views as a break from the approach under EU law. The consultation closes on 9 February 2022.

In our view, the most significant proposals include:

- New growth and international competitiveness objectives for the FCA and PRA (which also incorporate climate change considerations), and the ability for the Treasury to set specific "have regards" which the regulators must consider when exercising their rules in specific areas of regulation.
- A requirement for regulators consider the potential impacts on deference arrangements (including equivalence decisions and Mutual Recognition Agreements) and assess compliance with relevant trade agreements as a matter of course when making rules and when setting general approaches on supervision.



- A new power for the Treasury to repeal retained EU law, which it will use to repeal the direct regulatory requirements which apply to firms and move them to the FCA and PRA rulebooks (allowing the regulators to tailor them for the UK market).
- The creation of a new limited Designated Activities Regime (DAR) for activities where the current Regulated Activities Order (RAO) framework and authorised persons regime are not necessarily appropriate, for example activities under the Short Selling Regulation and margin requirements for derivatives.
- Possible enhanced regulation for certain firms where the regulators' existing rulemaking powers are not sufficiently broad to allow them to make rules covering all areas of financial services regulation currently in retained EU law. This includes the potential for a more bespoke supervisory solution for various entities related to payments and e-money subject to direct regulatory requirements under retained EU law. Related to this, in a consultation published on 17 January 2022, the Treasury proposed to grant the Bank of England a general rulemaking power in relation to central counterparties (CCPs) and central securities depositories (CSDs) so that it can set appropriate rules for these firms.

The payments and e-money industry should pay particular attention to the Treasury's direction of travel. For payments and e-money firms subject to direct regulatory requirements under retained EU law, the Treasury confirms that where the existing powers of supervisors are unclear, the government will ensure that they have the necessary additional powers to replace the direct regulatory requirements in retained EU law. The Treasury recognises that this is likely to require a more detailed solution, rather than simply porting those firms into the "standard" FSMA authorisation regime. We think this positioning may potentially lead to more enhanced regulation for those industries in the long term.



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