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DOMEX :

REGULATORY & COMPLIANCE

REGWATCH SQUARE

REGULATORY NEWSLETTER

PRESENTATION

Square Management offers a quarterly regulatory watch newsletter, providing you with an overview of the latest updates related to compliance and regulatory requirements. RegWatch covers the following topics :

Square management

BANK & PRUDENTIAL

SPOT[1] CONTROLS

During the third quarter, the AMF published 3 SPOT checks on the following topics:

• 07/07/2022 - Best execution and best selection obligations applicable to Asset Management Companies (AMC).

☐ All the audited AMCs have implemented a best execution policy, but these policies are insufficiently precise and fail to provide certain required information.

☐ For AMCs using brokers, these policies did not specify the methodology and the documentary basis for the valuation.

☐ For some AMCs, the terms and criteria for selecting external service providers are not mentioned.

☐ The monitoring and evaluating system for the quality of execution is not or only slightly formalized, apart from the dedicated instances.

☐ Related to the control system of best execution and best selection, the permanent control procedures for best execution are insufficient.

• 13/07/2022 - System for combating market abuse in place within asset management companies

☐ The procedural body, as far as the master documents are concerned, has many shortcomings.

☐ The market abuse detection selection process is not formalized for the majority of AMCs.

☐ A minority of AMCs have set up a formal process for modifying the rules and set alert thresholds.

☐ Regarding the practical implementation of the system, the rules and alert thresholds set by the audited AMCs prove to be perfectible.

☐ The need for regular control (2nd and 3rd level) of the manual instruction of the alerts is necessary in order to ensure on a regular basis the validity of their classification without follow-up.

☐ The control apperatus is insufficient for the majority of AMCs.

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1 : SPOT : Supervision des Pratiques Opérationnelles et Thématiques (ou contrôles)

- **30/08/2022 - Simple, transparent and standardized securitization (STS)**

☐ Some AMCs did not have dedicated procedures governing the granting of the STS label.

☐ Most Investment Services Providers (ISP) do not have a committee dedicated to the STS qualification of operations.

☐ All the institutions had sent a notification to ESMA for all of their STS securitizations.

☐ Concerning the information sent to the AMF, as the Competent National Authority (CNA), the control mission noted strong disparities.

☐ Carrying out ex ante checks to ensure that the operation complied with the requirements of the label was not systematic.

☐ The ex-post control system of the controlled ISPs is partially satisfactory.

For further information: AMF
AMF
AMF

DURABILITY

ESMA published on July 8th, the long-awaited review of the MiFID II product Governance guidelines. This consultation closes on 7 October 2022 and is expected to lead to a final report by Q1 2023. The document published by ESMA is aimed at competent authorities, firms that are subject to MiFID II (therefore encompassing manufacturers and distributors) and investors.

The main proposals in the draft guidelines relate to:

• The specification of any sustainability-related objectives a product is compatible with;

• The practice of identifying a target market per cluster of products instead of per individual product ("clustering approach");

• The determination of a compatible distribution strategy where a distributor considers that a more complex product can be distributed under non-advised sales;

• The periodic review of products, including the application of the proportionality principle.

• Key points on cost-benefit analysis

• Good practices related to product governance

• Illustrative examples and case studies which aim to help firms to comply with the relevant product governance requirements

Several recent regulatory developments, such as the following, have prompted a review of the governance guidelines:

• The EC's Capital Markets Recovery Package and subsequent Amending Directive

• Sustainability-related amendments to the MiFID II Delegated Directive

• Recommendations on the product governance guidelines by the ACP

• Findings of ESMA's 2021 Common Supervisory Action on product governance

These guidelines seek to ensure a consistent and harmonised application of the product governance requirements and therefore to make sure that the objectives of MiFID II can be efficiently achieved. By implementing these guidelines, ESMA aims at strengthening investor protection, a key objective for ESMA.

For further information: ESMA

IFR (INVESTMENT FIRMS REGULATION) / IFD (INVESTMENT FIRMS DIRECTIVE)

EBA and ESMA publish guidelines to harmonize the Supervisory Review and Evaluation Process (SREP) of investment firms. On July 21st, the European Banking Authority (EBA) and European Securities and Markets Authority (ESMA) jointly publish final guidelines that aim to harmonize common supervisory practices, procedures and methodologies for the SREP of investment firms. These guidelines are based on the Investment Firms Directive (IFD) and Investment Firms Regulation (IFR).

These final guidelines describe the common regulatory products, procedures and methodologies, that are to be used for the evaluation of the main SREP components for investment firms:

- a business model analysis (BMA) that focuses on the viability and sustainability on the firm's business model and underlying strategic plans; i.e., how the business is organized and ran by the firm's management body. The additional objective is to also identify firms' key vulnerabilities;

- the assessment of internal governance arrangements and firm-wide controls with regard to the firm's risk profile, business model, complexity, size and nature. Under this guideline, it must be ensured that the following areas are monitored and assessed: internal governance, control and risk frameworks, management composition and organization, remuneration information and business continuity planning, etc.;

- the assessment of risks to capital, segmented into 'risk-to-client', 'risk-to-market', 'risk-to-firm' and other risks and the evaluation of potential orderly wind-down of the investment firm. This component is accompanied by a capital adequacy assessment which may lead to additional own funds requirement;

- the assessment of liquidity risk, under severe but realistic conditions, to evaluate how the firm may be prepared to mitigate potential liquidity outflows (intraday, available liquid resources and funding) and its management (organization, policies, procedures and internal control framework). Likewise, it is combined with a liquidity adequacy assessment which may also lead to additional specific quantitative and/or qualitative liquidity requirements.

These guidelines also introduce:

1. a scoring system, for all the above SREP components, that includes risk and viability scores, which will allow for better comparability across investment firms;

2. the monitoring of key indicators (financial and non-financial) to manage the financial conditions, reporting and risk profile of the firm;

3. the application of supervisory measures in the overall SREP assessment by competent (national) supervisory authorities. These measures will apply on the capital and liquidity risks, vulnerabilities and deficiencies identified in the firm.

For further information: EBA

ECONOMY & FINANCE

THREE REPORTS FROM REGULATORS AGREE ON CLOUDED ECONOMIC FORECASTS

The European Supervisory Authorities[2] & the French AMF highlight in their recent risk reports the deteriorating economic situation and risks environment fueled by the war in Ukraine.

These reports draw a darkened economic global picture and deteriorating perspectives as the post-pandemic recovery period is strongly impacted by high levels of inflation, energy and commodity prices and volatility amplified by geopolitical tensions, especially the war on Ukraine.

The main risks outlined through the reports are all heightened, to different degrees, by the Russian war. At the economic and financial levels, rising financing costs (after a long period of low interest rates) combined with higher market volatility and increasing companies and individual debts mean that financial institutions and market participants will need to strictly monitor their credit, liquidity and market risks.

At the consumers market level, higher inflation and increasing costs of finance are sharply impacting the savings and investments of households and, by side effect, the cost of living and purchasing power.

On the sustainable and innovation finance fronts, several EU members are forced to temporarily transition to less green energy (mainly coal) which will hamper ESG initiatives. The Investments in crypto-assets is also brought out as still being highly speculative and dangerous for unwise and uninformed investors.

ESA insist on quickly taking actions to monitor and better cope with degrading assets and market conditions, worsening inflation and volatile energy and commodity prices, the spreading of risky products and investments, and finally the environmental and digital/cyber risks.

For further information: AMF

EBA

ESMA

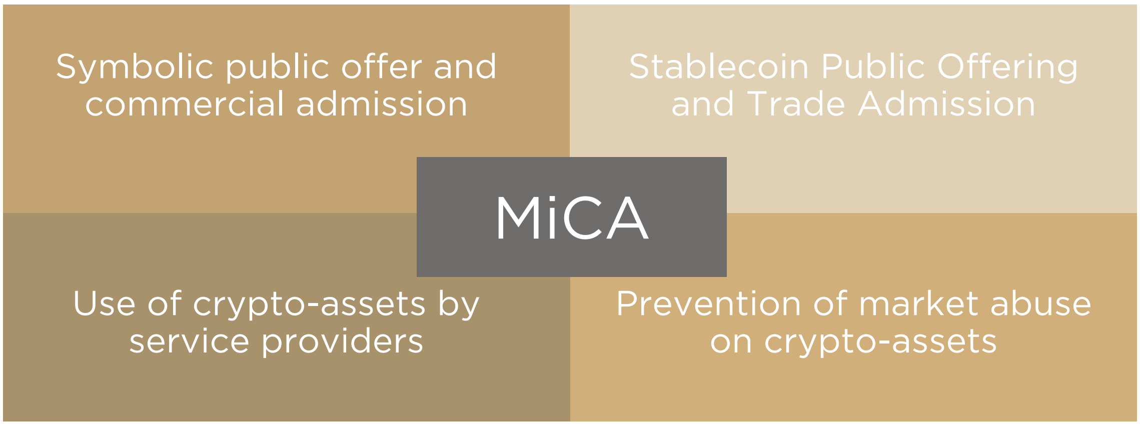
2 : ESA is comprised of the three supervisory authorities of the European Financial sector: the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority.

DATA PRIVACY / CYBER SECURITY

THE EUROPEAN REGULATION "MARKETS IN CRYPTO-ASSETS" APPROVED

Inter-institutional negotiations (European Parliament, Council and Commission) on the proposed European law regulating the crypto-asset markets ended on June 30th, 2022 and a provisional political agreement was reached. The AMF, which supports this agreement and anticipates its rapid entry into force.

The European Regulation on Crypto-Asset Markets (MiCA) aims to regulate crypto-assets that are not covered by existing regulations on financial instruments by developing an appropriate and balanced European regulatory framework. MiCA is one of many measures related to digital finance in Europe («digital finance package»). This text covers a number of topics, including:



This rule is meant to replace the national frameworks developed by some EU member states, such as the Pacte law of May 22nd, 2019, which established a particular framework in France for initial coin offerings (ICOs) and digital asset services providers (DASP).

Similar to the voluntary license in the French system, the MiCA regulation requires crypto-asset service providers (CASPs) to obtain a license. Providers holding a MiCA settlement license will be eligible for the European passport and authorized to offer their services throughout the EU.

In addition, information on the environmental and climate footprint of service providers will be required.

Unless they meet specific requirements set out in the text or in existing financial instruments legislation, non-fungible tokens (NFTs) will not be subject to the MiCA rule. Within 18 months, the European Commission must determine whether a single regulatory framework for NFTs is necessary, as well as any new market-related concerns.

For further information: [AMF]

AML-FT

ANTI-MONEY LAUNDERING AND BANKING SERVICE

The Commission proposes establishing a new institution at the EU level charged with coordinating member states' Financial Intelligence Units in their supervision of the financial system. At its core, the initiative seeks to combine financial supervision and coordination functions at the EU level into a new institution with 250 staff and improved tools at its disposal

The proposed EU Authority would also have the power to directly supervise certain high risk financial institutions with activities in several member states. The new authority would be able to gather and analyze data across the EU, prevent and investigate wrongdoing, and design more evidence-based policies to tackle money laundering and terrorist financing (AML/CTF).

Supervision will fall – at least in part – under Community competence and no longer under national competence. It will thus have to be ensured by the new Anti-Money Laundering Authority (AMLA), having powers of sanction with regard to the establishments under its supervision. It will be intended to replace the current specialized unit within the EBA. The AMLA will enable increased cooperation and coordination between national FIUs[3], in order to improve the detection of unauthorized cross-border operations. As such, the European Commission also intends to create its own "black list" and "grey list", in line with the recommendations of the Financial Action Task Force (FATF). AMLA will aim to ensure better convergence of supervisory standards at EU level through a single supervisory system (FIU.net platform to centralize information sharing between FIUs). The AMLA will directly supervise certain actors with cross-border activity and considered "at risk", in order to act immediately. It will thus be empowered to impose fines directly in the event of failures or breaches of AML/CFT compliance.

For further information: European Commission

European Commission

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3 : FIU : Financial Intelligence Unit

SUSTAINABLE FINANCE

ELAN LAW - TERTIARY DECREE
TERTIARY ECO-EFFICIENCY SCHEME (DEET)

The tertiary decree which came into effect on July 1, 2022 sets the levels of energy and environmental performance requirements that the buildings located in metropolitan France must meet, concerning the following five result requirements:

- Optimization of the energy design of the building independently of the energy systems implemented
- Limitation of primary energy consumption
- Limitation of the impact on climate change associated with its consumption
- Limiting the impact of building components on climate change
- Limitation of uncomfortable situations in the building during the summer period

The tertiary decree requires companies to make energy savings in buildings for tertiary use of more than 1000 m^2. All public and private buildings in which tertiary activities are carried out on a floor area greater than or equal to 1000 m^2 are now concerned. That is approximately 800 million m2 out of the 960 million m2 that make up the French tertiary park.

In terms of constraint or incentive factors, it seems that the tertiary decree has decided, favoring the goodwill of those subject to it as a lever for efficiency.

If the owner or the lessee does not respect his obligations to reduce consumption and he does not justify his failures, the decree announces sanctions which can go up to an administrative fine of 1500 ^{2} for natural persons and 7500 ^{2} for legal persons. In the event of non-compliance with reporting, no financial penalty will be applied. If the owner or the lessee does not transmit the consumption data via the online platform, he is liable to a formal notice to transmit them within 3 months. Failing this, the document retracing the ineffective formal notices will be published on a governmental service website: this is the principle of “name and shame”.

For further information: LégiFrance

LesEchos

THE SURPRISING INCLUSION OF NON-GREEN ENERGIES IN THE EUROPEAN ENERGY TAXONOMY

On June 6th, 2022, the European Parliament did not object to the Commission's delegated regulation (EU) 2022/1214 of March 9th, 2022 which set out to include certain gas and nuclear activities into the EU Taxonomy; a classification system that establishes a list of environmentally sustainable activities.

The delegated act will apply as of January 1st 2023. The Taxonomy is a corner stone of the EU Action Plan on Sustainable Financing and fills the need to introduce a common classification system in order to re-direct investments towards sustainable projects.

The included activities are however subject to technical screening criteria which, among others, defined CO2 emissions thresholds. Yet, these do not seem to satisfy civil society organizations as five environmental groups[4] have decided to leave the European Commission-led expert group on sustainable finance on September 14th, 2022 expressing their view that the inclusion of gas and nuclear activities into the Taxonomy would divert investments away from sustainable activities such as renewable energy.

A view shared by sustainable investors such as Triodos who are also concerned that including these activities could encourage greenwashing. Austria had previously warned it would pursue legal action if gas and nuclear activities would be included in the taxonomy, a move for which Luxembourg, Spain and Denmark have manifested support.

Meanwhile, four environmental group[5] have on September 19th, 2022 started legal action against the EU Commission arguing that the delegated regulation is inconsistent with the European Climate Law nor does it comply with EU obligations under the Paris Agreement. The EU Commission has 22 weeks to reply, after which the EU Court of Justice will rule on the matter.

For further information: European Parliament

Euractiv

Triodos

European Commission

4 : BEUC, Birdlife, ECOS, T&E and WWF

5 : ClientEarth, WWF's European Policy Office, Transport & Environment (T&E), and BUND (Friends of the Earth Germany)

CLIMATE RISKS

ENERGY PRICES: COMMISSION PROPOSES EMERGENCY MARKET INTERVENTION TO REDUCE EUROPEANS' BILLS

The Commission is proposing urgent intervention in European energy markets to deal with recent dramatic increases in energy prices.

The EU is facing the effects of a severe mismatch between energy demand and supply, largely due to Russia's continued use of its energy resources. In order to alleviate the increased pressure on households and businesses in Europe, the Commission is taking a further step in tackling this problem by proposing exceptional measures to reduce electricity demand, which will help reduce the cost of electricity for consumers, as well as measures to redistribute surplus income from the energy sector to end customers. This proposal is a continuation of the measures previously adopted to ensure the filling of gas storage, and reduce the demand for gas to prepare for next winter. The Commission is also continuing its work to improve the liquidity of market operators, bring down gas prices and reform the organization of the electricity market in the longer term.

The first response to combat high prices is to reduce demand. Such a reduction can have an impact on electricity prices and have an overall calming effect on the market. In order to target the most expensive hours of electricity consumption, where the production of electricity from gas has a significant impact on the price, the Commission proposes an obligation to reduce electricity consumption by at least 5% during certain peak hours. Member States will be required to determine the 10% of hours for which the expected price is the highest and to reduce demand during peak hours.

The Commission is also proposing a temporary revenue cap for «infra-marginal» electricity producers, i.e., those using lower-cost technologies, such as renewables, nuclear and lignite, which supply electricity to the grid at a cost lower than the price level set by the most expensive «marginal» producers. These sub-marginal generators have made windfall revenues, while their operating costs have remained relatively stable, as expensive gas-fired power plants have driven up the wholesale price of the electricity they receive. Member States engaged in electricity trading are encouraged, in a spirit of solidarity, to conclude bilateral agreements with a view to sharing part of the inframarginal revenues collected by the producer State for the benefit of end users in the Member State to low power generation. These agreements must be concluded no later than 1 December 2022 when a Member State's net electricity imports from a neighboring country reach at least 100%.

Third, the Commission is also proposing a temporary solidarity contribution on excess profits generated by activities in the oil, gas, coal and refining sectors which are not covered by the inframarginal income ceiling. This time-limited contribution would maintain incentives to invest in the green transition. It would be levied by Member States on the profits of 2022 exceeding by more than 20% the average profits of the previous three years. Revenue would be collected by member states and redirected to energy consumers, including vulnerable households, hard-hit businesses and energy-intensive industries.

For further information: European Commission

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