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Introduction

Our 2022 report focused first on the regulatory responses to the Covid-19 pandemic and then turned its attention to developments in sustainable finance and FinTech & RegTech. While the world has moved on from the pandemic and the related emergency measures in capital markets, regulation related to sustainable finance and digital finance has developed significantly and so remains a central focus of this report. In the case of sustainable finance, the EU remains at the forefront of developments but it remains an open question as to how its approach may influence global trends. In the case of digital finance, a combination of increasing public participation, limited regulation and financial failure has inevitably focused attention on investor protection and potential regulatory intervention. In this report we also consider the implications of financial sanctions for capital markets following the call of G7 leaders in 2023 for sanctions to be imposed on Russia following its invasion of Ukraine.

1. Sustainable finance and ESG

Since our 2022 report, which focused on the EU Taxonomy and Green Bond Framework, there have been significant developments in the context of financial reporting, disclosure by financial market participants relating to their sustainability practices and due diligence requirements for companies in connection with their supply chains. The EU has continued to take a lead on these issues, while progress in the US has been slower and more contested in terms of the political process and legal challenges. A clear dividing line has opened up with regard to financial materiality with the EU adopting a double materiality approach (requiring disclosure of the impact of the company's activities on sustainability) while other standard setters, like the Task Force on Climate-Related Financial Disclosures (TCFD) and the International Sustainability Standard Board (ISSB) are more focused on single materiality (the financial impact of sustainability risks on the company). Although less clearly demarcated, there is also some evidence that fiduciary concerns are more prominent in the US as a constraint for sustainable investing.

1.1. Developments in the EU

1.1.1. The EU Corporate Sustainability Due Diligence Directive

As part of the EU's broader sustainability agenda and commitment to achieving the goals outlined in the European Green Deal, there has been a growing emphasis on the need for companies to conduct thorough due diligence on their supply chains and business operations to identify and address adverse environmental and social impacts.

Background: On 23 February 2022, the Commission submitted to the European Parliament and to the Council a proposal for a directive on corporate sustainability due diligence (CSDDD). The Council adopted its general approach on 1 December 2022. Even though on 14 December 2023 the Council and the European Parliament reached a provisional agreement on CSDDD, several Member States withdrew their support necessitating a reopening of negotiations. The voting schedule was repeatedly postponed, and significant concessions were required to move the process closer to completion, culminating in the final votes in April and May 2024.

Objectives and obligations: The CSDDD aim to enhance the protection of the environment and human rights in the EU and globally through the establishment of a requirement for the companies covered by its scope of application to systematically identify, prevent, mitigate, and account for the adverse impacts of their activities on human rights, the environment, and good governance throughout their value chains. This entails integrating due diligence into their policies and risk management systems. In-scope companies will have to identify and effectively address risks related to human rights violations, environmental degradation, and corruption. They will also have to engage meaningfully with stakeholders on due diligence matters and to provide remediation to actual adverse impacts, also ensuring access to effective remedies for victims of adverse impacts related to corporate activities. Additionally, CSDDD requires companies to adopt a transition plan for climate change mitigation ensuring that their business model and strategy are compatible with the Paris agreement on climate change.
The obligations imposed to the companies directly covered by the CSDDD relate to their own operations, but also to the operations of their subsidiaries and the operations carried out by their business partners[2] in their chain of activities. Furthermore, it lays down rules on penalties and civil liability for infringing those obligations, whilst leaving it up to Member States to designate the authorities with enforcement powers.
Scope of application: The Directive will apply to companies formed in accordance with the legislation of a Member State and having more than 1000 employees on average as well as a net worldwide turnover of more than EUR 450 million in the last financial year, for which annual financial statements have been or should have been adopted. It will also apply to non-EU companies withed a net turnover of more than EUR 450 million in the Union in the financial year preceding the last financial year. The Directive also applies in certain other cases as provided for in Article 2 thereof.

1.1.2. Financial Reporting - the EU Corporate Sustainability Reporting Directive (CSRD)

The role of the financial system as a key conduit for the transition to net zero and sustainability policy more generally means that reporting standards are a key factor in driving investment and financing decisions. The traditional focus on single or financial materiality was based on the premise that it was the key issue for shareholders and efficient markets but the sustainable finance agenda has shifted the focus somewhat to the impact of corporate activities on the environment and communities. The change in emphasis is most evident in the EU, which has developed its sustainable finance regulatory framework on this basis and has now issued financial reporting standards which follow that approach.[3]

Directive (EU) 2022/2464 of the European Parliament and of the Council "amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive

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[2] The final text of the CSDDD restricts the scope of the obligation to "upstream" business partners, in charge of the production of goods or the provision of services, excluding "downstream" business partners in charge of the distribution, transport and storage of the product.
[3] See the European Sustainability Reporting Standards (ESRS) at the following link: https://www.efrag.org/lab6?AspxAutoDetectCookieSupport=1, enshrined under Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards.

2013/34/EU, as regards corporate sustainability reporting", significantly revises Directive 2013/34/EU concerning non-financial statements. The adoption of the new terminology of "sustainability reports" is based on the recognition of the increasing economic importance of the information contained in these statements. In this context, the term "non-financial" may be misleading as it implies that the information does not have economic significance.
The most significant changes introduced by the above Directive are summarized as follows:

a. The obligation to prepare and disclose sustainability reports applies to all large companies (regardless of whether they are entities of public interest and regardless of the number of employees), as well as all small and medium-sized enterprises, excluding very small enterprises listed on a regulated market in an EU Member State. However, the entry into force of these obligations will be phased in gradually, starting with larger companies.
b. Third-country entities with significant activity in the Union, i.e., a net turnover exceeding EUR 150 million in the Union and a subsidiary (excluding very small subsidiaries) or a branch in the EU with a net turnover exceeding EUR 40 million, will also be subject to the duty to disclose sustainability reports.
c. The Directive also expands and standardizes the content of sustainability reports to ensure comparability. It should provide information not only related to how sustainability issues affect the company's development, performance, and position, but also to the company's impact on sustainability issues (i.e. double materiality).
d. Companies must also describe the process to identify the information included in the sustainability report.
e. The obligation to express an opinion, based on a commitment to limited assurance (not reasonable assurance, at least for now), is established for statutory auditors or audit firms regarding the compliance of the submission of sustainability reports with the requirements of the Directive, including their compliance with the reporting standards for sustainability reports, the process the company employs to identify the information submitted, and compliance with the requirement to present sustainability information, as well as compliance with the reporting requirements of Article 8 of Regulation (EU) 2020/852.
f. The European Financial Reporting Advisory Group (EFRAG), a private association established in 2001 under Belgian law, develops the reporting standards for sustainability reports. Since 2022, it has provided Technical Advice to the European Commission in the form of fully prepared draft EU Sustainability Reporting Standards (ESRS) and/or draft amendments to these Standards. EFRAG is also in charge of evaluating and endorsing International Financial Reporting Standards (IFRS) for adoption in the European Union.

1.1.3. The EU's Sustainable Finance Disclosure Regulation (SFDR)

An ambitious yet highly debated policy instrument in the EU sustainable finance framework has been the Sustainable Finance disclosure Regulation (SFDR).[4] Introduced in 2019, it aims to enhance market actors' transparency regarding how they contribute to sustainability goals through their investments and financial advice. At its core, it revolves around reporting obligations, which should implicitly nudge market actors to reorient cash flows towards ESG goals.[5] It applies to a broad spectrum of institutional investors, including pension funds, asset

[4] Regulation 2019/2088/EU.
[5] See 'Explanatory Memorandum', Regulation 2019/2088/EU.

managers, insurance products, AIFMs but also banks providing portfolio management services and financial advisers.[6]

According to the default regime, investors and financial advisers must report on the extent to which they consider sustainability matters in their investment decision-making processes and investment advice. They must also provide information on the link between sustainability factors and their remuneration practices ('entity-level disclosures').[7] Such disclosures are grounded in the 'double materiality' approach mentioned above: in other words, requiring market actors to report on how sustainability risks affect the return and value of their investments as well as on the adverse impacts of their investments on the environment and society (principal adverse impacts, PAIs).8

The SFDR also imposes more stringent reporting requirements for 'sustainable' funds, particularly those that incorporate environmental and social objectives 'among others' (Art 8) and those that have 'sustainable investment' as their 'main' objective (Art 9). 'Art 8' and 'Art 9' funds have to report on the basis of 21 indicators set out in a Delegated Act.[9] For funds promoting environmental (and not social) characteristics, additional information about their share of 'sustainable investments' in line with the Taxonomy Regulation is required.[10] Sanctions for non-compliance are determined by EU Member States at national level.

Since our 2022 report, SFDR provisions have gradually become applicable, following a phase-in approach. While the first reference period for market actors to report on the 'principal adverse impact' has lasted until 30 June 2021, the first reference period for all the other reporting indicators is the current one, between 1 January 2023 and 31 December 2024. The main challenges in the application of such requirements related to the complexity of the requirements, the interaction with other EU initiatives as well as the risks of misstatements and miscommunication around market actors' sustainability practices ('greenwashing').

For instance, the meaning of the notion of 'sustainable investments' raised several questions among market participants. The EU Commission clarified in a recent Q&A that despite being a broader concept, it would also be interrelated to the EU classification system for sustainable economic activities ('EU Taxonomy'). Taxonomy-aligned activities would automatically classify as 'sustainable investments'.[11] European Supervisory Authorities (European Banking Authorities (EBA), ESMA and EIOPA) have also been involved in a preliminary review of the Regulation, also focussing on the potential simplification of the requirements. This led to a proposal for first amendments which would, among others, expand the set of social indicators and strengthen reporting on GHG emission reduction targets. Importantly, they have also

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[6] Art 2 ibid.

[7] Art 6, Art 5 Regulation 2019/2088/EU.

[8] Art 6 Regulation 2019/2088/EU.

[9] Annex I, Commission Delegated Regulation (EU) 2022/1288/EU.

[10] Article 6 of Regulation (EU) 2020/85, see also ANNEX II Amendments to answers to questions on the interpretation of Regulation (EU) 2019/2088, submitted by the European Supervisory Authorities, adopted on 6 July 2021 and 13 May 2022 p. 4 https://www.esma.europa.eu/sites/default/files/2023-04/Amendments_to_answers_to_questions_on_the_interpretation_of_Regulation_%28EU%29_20192088_SFDR.PDF

[11] Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the Sustainable Finance Disclosure Regulation 2023/C 211/01 (2023) paras 4-5.

recommended introducing a 'dashboard' for funds to summarise the key information about their sustainability strategy, which should enhance the accessibility of the documentation.[12]

Supervisors have also identified several shortcomings and instances of greenwashing across SFDR reporting practices at fund level. For instance, ESMA identified a mismatch between the original rationale of the SFDR, conceived as a disclosure regime, and its application. It warned that the distinction between 'traditional', Art 8 and Art 9 funds only serves a classification purpose, but it should not suffice to evaluate the degree of sustainability of a fund. ESMA also warned against misleading practices like the application of SFDR as a labelling regime. For instance, funds recurrently report in investors' advertising material that they are 'Art 8' and 'Art 9' like an 'earned label, overemphasising what it actually means'.[13] 'Greenwashing' practices also include funds acting as ESG products in practice while not providing full disclosure on sustainability objectives under Art 8 and 9, which would also represent a legal breach of the SFDR. ESMA has also highlighted the use of vague language in advertising material and in prospectuses, as well as the lack of specificity around sustainability objectives.[14]

In the light of these shortcomings, the EU Commission has launched a consultation on potential changes to SFDR, focussing on the simplification of requirements and on the merits of a labelling regime for funds.[15] This shift would align the legal requirements with market practices and ongoing discussions in the UK, covered in the following section.

The introduction of a labelling regime could certainly address the wide-spread concern among investors around the lack of clarity and comparability of information on the degree of 'sustainability' of financial products. However, effective supervisory enforcement action could equally facilitate the uniform application of SFDR and mitigate the risks of 'greenwashing' practices.

1.1.4. The UK labelling regime

The UK Financial Services Authority ("FCA") has put in place Sustainability Disclosure Requirements (SDR) including an investment labels regime to apply from May 2024.[16] These were adopted by the FCA after detailed engagement with a range of stakeholders, including an industry working group, other regulators and industry and consumer groups.[17]

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[12] EBA, ESMA, EIOPA, Final Report on draft Regulatory Technical Standards on the review of PAI and financial product disclosures in the SFDR Delegated Regulation (2023) Paras 41-47-52, p. 164 https://www.esma.europa.eu/sites/default/files/2023-12/JC_2023_55_-_Final_Report_SFDR_Delegated_Regulation_amending_RTS.pdf

[13] ESMA, Progress report on greeenwashing, Para 104, p. 42 https://www.esma.europa.eu/sites/default/files/2023-06/ESMA30-1668416927-2498_Progress_Report_ESMA_response_to_COM_RfI_on_greenwashing_risks.pdf

[14] ibid, pp. 42-43.

[15] EU Commission, Targeted consultation on the implementation of the Sustainable Finance Disclosures Regulation (2023) https://finance.ec.europa.eu/regulation-and-supervision/consultations/finance-2023-sfdr-implementation_en

[16] https://www.fca.org.uk/publication/policy/ps23-16.pdf

[17] https://www.fca.org.uk/publication/fca/dlag-terms-of-reference.pdf

The package of measures was put in place based on FCA research which suggested that investors weren't confident that sustainability-related claims made about investments were genuine. Also, that firms were using terms such as 'green', 'ESG' or 'sustainable' in an inconsistent manner.[18]

Unlike the SFDR, the SDR regime is the first comprehensive regulatory initiative specifically designed as a labelling regime.

It includes:

- **an anti-greenwashing rule** for all FCA authorised firms to make sure sustainability-related claims are fair, clear and not misleading;[19]
- **product labels** for UK firms based on clear sustainability goals and criteria; and
- **naming and marketing requirements** so products can't be described as having a positive impact on sustainability when they don't have this impact.

This will require firms to:

- assess any products that say that they aim to achieve positive sustainability outcomes using the qualifying criteria;
- assess products against the naming and marketing requirements; and
- prepare relevant consumer-facing disclosures, detailed product-level disclosures and other statements where relevant.

The requirements will be effective on a staggered basis from May 2024 to December 2026.[20] The labelling regime, which can be used from 31 July 2024, includes the following four labels:

- Sustainability Impact
- Sustainability Focus
- Sustainability Improvers
- Sustainability Mixed Goals

Each of the labels has sustainability objectives that aim to improve or pursue positive outcomes for the environment and/or society. There are detailed requirements that must be met for each of the labels.[21]

It will be interesting to see how many firms seek to comply with the labelling requirements, and how many rename their funds. Also, whether the labels are compatible with other sustainability disclosure and naming requirements in the EU and US.

1.1.5. Climate disclosure standards in New Zealand

1.5.1. General

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[18] https://www.fca.org.uk/news/press-releases/sustainability-disclosure-and-labelling-regime-confirmed-fca#:~:text=Research%20has%20shown%20that%20investors,ESG'%20or%20'sustainable'.

[19] https://www.fca.org.uk/publication/finalised-guidance/fg24-3.pdf

[20] https://www.fca.org.uk/publication/policy/ps23-16.pdf ("PS 23-16") at page 12.

[21] PS 23-16, Annex 2 at p. 98

Climate reporting standards are now in force in New Zealand. Applicable reporting entities are required to publish annual climate statements complying with the climate standards for annual reporting periods beginning on or after 1 January 2023.

In October 2021, New Zealand enacted the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021. That Act amended the Financial Reporting Act 2013 to establish the statutory framework for requiring the largest financial market participants in New Zealand to disclose information about the risks and opportunities climate change presents to their businesses, on a clear, comparable, and consistent basis. The legislation gave the External Reporting Board (XRB), New Zealand's financial reporting standard setter, the function of issuing climate standards under the climate-related disclosure framework. The Financial Markets Authority has the function of monitoring compliance, and enforcing the climate standards.

The legislation states the purpose of climate standards is to "provide for, or promote, climate -related disclosures, in order to-

(a) encourage entities to routinely consider the short-, medium-, and long-term risks and opportunities that climate change presents for the activities of the entity or the entity's group ;

(b) enable entities to show how they are considering those risks and opportunities; and

(c) enable investors and other stakeholders to assess the merits of how entities are considering those risks and opportunities."

1.5.2. The Climate Standards

The External Reporting Board has issued three climate standards, and related guidance.
These standards have the force of law and are of mandatory application for the reporting entities subject to them.

Aotearoa New Zealand Climate Standard 1: Climate-related Disclosures (NZ CS 1)

NZ CS 1 is the main disclosure standard. Based on TCFD recommendations, it aims to enable primary users to assess the merits of how entities are considering climate-related risks and opportunities, and then make decisions based on those assessments. NZCS 1 contains the climate-related disclosure requirements in relation to four thematic areas - governance, strategy, risk management, and metrics and targets.

Aotearoa New Zealand Climate Standard 2: Adoption of Aotearoa New Zealand Climate Standards (NZ CS 2)

NZCS 2 was issued in recognition that it may take time to develop the capability to produce high-quality climate-related disclosures and that some disclosure requirements, by their nature , may require an exemption. The standard provides that an entity may elect a limited number of adoption provisions, some exempting certain disclosures and others enabling alternative information to be disclosed .

Aotearoa New Zealand Climate Standard 3: General Requirements for Climate-related Disclosures (NZ CS 3)

This standard establishes principles and general requirements to enable the provision of high-quality climate-related disclosures.

A key element is 'fair presentation". Where compliance with the specific requirements of the climate standards is insufficient to show a fair presentation, additional disclosures must be provided. The standards contain disclosure objectives to assist entities in determining whether to disclose additional information.

NZ CS 3 sets out principles to be applied, underlying concepts such as materiality, and general requirements.

In respect of “single” or “double” materiality, the XRB has acknowledged the topical and ongoing global debate and considered what it means for the climate-related disclosure framework. The XRB Board considered that “using simplified labels such as ‘single’ or ‘double ’materiality may serve to reduce, rather than enhance, different understandings of this topic. It also questioned whether the directional effect really matters (i.e., impacts of climate on an entity versus impacts of an entity on the climate), when the fundamental concept of materiality is whether providing or withholding the information is likely to influence primary users’ decision making. The XRB Board further noted that the requirements in NZ CS 1 already require information to be disclosed about an entity’s impact on climate change (for example, the disclosure of scope 1, 2 and 3 GHG emissions, the transition plan aspects of an entity’s strategy, and disclosure of an entity’s GHG emissions targets).”

1.5.3. Application

The criteria for entities required to prepare and publish climate statements are set out in the Financial Markets Conduct Act 2013. These are entities which under the Act are considered to have a higher level of public accountability than other reporting entities under that Act, including:

- registered banks and certain other financial institutions with total assets of more than NZ$1 billion;
- managers of registered investment schemes (other than restricted schemes) with greater than NZ$1billion in total assets under management
- licensed insurers with greater than NZ$1billion in total assets under management and/or annual gross premium income greater than NZ$250 million
- listed issuers of quoted equity or debt securities with a value greater than NZ$60 million

The first climate statements have been lodged on the publicly- accessible Climate-related Disclosures Register of the New Zealand Companies Office from Q1 2024.

1.6. ISSB standards

The EU’s double materiality approach stands in contrast to two evolving global frameworks for sustainability related reporting, the TCFD and the ISSB, which are focused more on financial materiality. The ISSB’s IFRS S1 is a general standard that requires an entity to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity’s cash flows, its access to finance or cost of capital over the short, medium, or long term. It also requires an entity to disclose information about its greenhouse gas emissions. IFRS S2 is a more detailed standard that applies to climate related risks to which the entity is exposed and climate-related opportunities available to the entity. It requires an entity to disclose, inter alia, its greenhouse gas emissions, adaptation plans and mitigation strategies, governance and management of such risks and opportunities.

1.7. Voluntary carbon markets and credits

Voluntary Carbon Markets ("**VCMs**") are markets where carbon credits ("**VCCs**") are purchased by corporations and other organisations for voluntary use to offset carbon emissions rather than to comply with regulatory requirements or legally binding emission reduction obligations.

Many believe that high integrity VCCs purchased by businesses can play an important role in supporting the transition to Net Zero. But there also is a concern that without adequate regulation or global standards, the purchase of carbon credits could be used as a substitute for direct business emissions reduction.[22] Also, there is a need to improve the integrity and transparency of VCMs. Commentators note the many challenges in this evolving area.[23]

The Integrity Council for the Voluntary Carbon Market ("**ICVCM**") is an independent governance body for global VCMs.[24] It seeks to address concerns about VCCs by setting and enforcing definitive global threshold standards so high-quality carbon credits channel finance towards genuine and additional greenhouse gas reductions and removals that go beyond what can otherwise be achieved and contribute to the transition to Net Zero. [25]

The International Swaps and Derivatives Association ("ISDA") has undertaken work on the legal nature and implications of VCCs. In December 2021, it published a paper titled the "Legal Implications of Voluntary Carbon Credits" which considered the legal implications of VCCs.[26] The ISDA paper investigated the legal treatment of VCCs, including their property status, and key legal issues flowing from their treatment, for example, transfers, intermediation and security rights.

Based on a proposal by ISDA[27], the International Institute for the Unification of Private Law (UNIDROIT), recommended at its 101st Session (June 2022) the inclusion of a project on the legal nature of VCCs in its 2023-2025 Work Programme. The project is intended to provide guidance on private law issues to enhance confidence in VCCs transactions and support the development of a well-functioning market. A working group has been established and steps have been taken to coordinate UNIDROIT's sister organisations, including UNCITRAL.[28]

Notwithstanding the challenges, the UK financial services industry has recognised the commercial opportunities presented by VCMs. The London Stock Exchange is launching a VCM to facilitate financing at scale into projects that mitigate climate change. It is designed to support corporates that seek to offset residual or unavoidable emissions and provide investors to an asset class by providing a long-term supply of carbon credits.[29] The City of London has also formed the UK Voluntary Carbon Markets Forum.[30]

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[22] https://www.theccc.org.uk/publication/voluntary-carbon-markets-and-offsetting/

[23] https://www.theguardian.com/environment/2023/dec/13/critical-or-concerning-cop28-debates-role-of-carbon-markets-in-climate-crisis

[24] https://icvcm.org/

[25] https://www.isda.org/2021/12/01/legal-implications-of-voluntary-carbon-credits/

[26] https://www.unidroit.org/work-in-progress/voluntary-carbon-credits/#:~:text=On%2024%20January%202022%2C%20the,the%20legal%20nature%20of%20VCCs.

[27] https://www.unidroit.org/wp-content/uploads/2023/05/C.D.-102-14-Legal-nature-of-Voluntary-Carbon-Credits.pdf

[28] https://www.unidroit.org/wp-content/uploads/2023/05/C.D.-102-14-Legal-nature-of-Voluntary-Carbon-Credits.pdf

[29] https://www.londonstockexchange.com/raise-finance/sustainable-finance/voluntary-carbon-market

[30] https://www.cityoflondon.gov.uk/assets/Business/the-future-of-voluntary-carbon-markets.pdf

VCMs have a role to play in financing innovation and preserving natural capital. A focus on harmonising standards, creating standard contracts, and providing effective and transparent global markets can provide support and funding for the transition to Net Zero. It is essential that governments, regulators and private actors work together to ensure legal certainty and the integrity and effective operation of these markets.

1.8. Liability claims based on ecological activism

1.8.1. Relevance of climate and nature-related financial risks

Background

Investments in companies or activities exercised by securities dealers, issuers and investors that disregard the environment, biodiversity, climate change and accentuate nature degradation are submitted to both thorough regulatory and public scrutiny.

Transparency of investments, their disclosure and reporting requirements – not only for private financial institutions, but also for non-financial companies – are gradually improved and the standards for sustainability-related financial disclosure should be consistent, comparable and reliable.[31] According to Jean-Paul Servais: "Climate change comes with significant risks and opportunities that companies must disclose, and that investors need to know about."[32] In addition, climate change comes with significant risks and opportunities that companies must disclose, and that investors need to know about. Climate policies can also trigger and amplify market fluctuations as well as influencing the attractiveness of investments.

Based on the international standards set, rules are introduced at the national level by supervisory authorities and central banks, which are refined on an almost continuous basis. Linked to their enforcement, issues of compliance, accountability and liability arise. Basically, the focus can be placed on three potential categories of accountability and liability risks: greenwashing,[33] breaches of directors' duties, and corporate due diligence law.[34]

The **k**ey takeaways for investment and securities regulation are: how far are securities dealers, issuers and investors accountable if they do not take these risks adequately into account? Can they be rendered liable and under which circumstances?

1.8.2. The role of tremendous ecological activism

Pivotal influence

In part, the issue of liability is the result of the introduction of standards and rules by authorities mainly regarding disclosure and reporting requirements. Yet, the most important driver of

[31] ISSB issues inaugural global sustainability disclosure standards, 26 June 2023, [IFRS - ISSB issues inaugural global sustainability disclosure standards]
[32] Servais J-P, Sustainable, Digital and Non-Bank Finance: IOSCO's achievements and perspectives, Eurofi 2023 Financial Forum,13 September 2023.
[33] Elia Cerrato Garcia, Federica Agostini, The Green Bonds Market in the Light of European Commission's Proposal: Implications for Greenwashing Liability, in: Greening the Bond market, 2023.
[34] NGFS, Climate-related litigation: recent trends and developments, September 2023, p. 13; ngfs_report-on-climate-related-litigation-recent-trends-and-developments.pdf

liability claims is linked to the execution of financial operations that are relevant with view to climate- and nature-related risks. Currently, it is the result of a tremendous ecological activism. National and international courts are used both for liability matters and for political purposes. Complaints by individuals, interest groups pursuing particular interests, national and international NGOs are on the rise. According to the IPCC:

> "Mass social movements have emerged as catalysing agents in some regions, often building on prior movements including Indigenous Peoples-led movements, youth movements, human rights movements, gender activism, and climate litigation, which is raising awareness and, in some cases, has influenced the outcome and ambition of climate governance."[35]

Trend in complaints

The number of proceedings initiated and lawsuits filed on account of liability is expanding rapidly.[36] Litigation cases do not concentrate on greenhouse gas-emissions only, but include environmental, biodiversity and nature degradation. They can regard both physical risks as well as transition risks in case of misalignment for instance. Various addressees are facing such complaints, diverse jurisdictions and types of courts are confronted with these complaints at the regional, national, and international levels, and the cases regard diverse economic sectors including the financial one. In parallel, the legal arguments submitted get better elaborated and weighty. They are based on scientific and practical knowledge gained and underpinned by the urgency of the situation. Similarly, the trend in complaints brought before courts questioning the role and accountability of securities dealers, issuers and investors and claiming their liability for disregarding nature- and climate-related financial risks is gaining momentum.

Consequences for securities dealers, issuers, and investors

It can be assumed that the courts will apply core legal principles[37] to delimit the responsibility and liability of respondents in concrete cases. Nonetheless, the reputational and financial risks of such legal cases should not be underestimated.[38] Securities dealers, issuers and investors face increasing liability risks. Besides respecting and implementing the existing rules, as precautionary measures, they should consider whether the approach they adopt is sufficient, accurate and timely.

Recently, the European Court of Human Rights found Switzerland in violation of human rights in a ruling for "Klimaseniorinnen". In fact, this ultra vires judgement recognises the existence of a human right to be protected against climate and, consequently, nature degradation.[39] It is

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[35] IPCC Synthesis Report of the IPCC Sixth Assessment Report (AR6): Climate Change, 2023, p. 18.

[36] e.g. see Grantham Research Institute on Climate Change and the Environment, Global trends in climate change litigation: 2023 snapshot (2024) p. 29 https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2023/06/Global_trends_in_climate_change_litigation_2023_snapshot.pdf

[37] Main principles are: The consistency with approaches and measures taken, proportionality of the state measures in view of the severeness of the risks and harm, Due process, public participation, adequate reason-giving, taking into account material issues, Good faith, effective participation in relevant international processes and implementation. Marjanac S and Hunter Jones S, 2022, Staying within Atmospheric and Judicial Limits, Core Principles for Assessing Whether State Action on Climate Change Complies with Human Rights, in: Rodriguez-Garavito C (ed.), Litigating the Climate Emergency, How Human Rights, Courts, and Legal Mobilization Can Bolster Climate Action, CUP.

[38] NGFS, Climate-related litigation: recent trends and developments, September 2023, p. 13.

[39] Case of Verein Klimaseniorinnen Schweiz and others v. Switzerland, Application no. 53600/20, 9 April 2024. In a similar vein, the Federal Constitutional Court of Germany delivered a ground-breaking decision in 2021 challenging the effectiveness of the Federal Climate Protection Act and asserting that the Act did not adequately

now assumed, that it will definitively reinforce the trend in liability claims. Thus, the probability of being faced with lawsuits independently from the implementation of the existing rules is on the increase in the medium- and long-term.

2. Financial sanctions

2.1. Background and context

Financial sanctions have come to the fore recently as a response to the Russian invasion of Ukraine, with the US, the EU and the UK implementing measures that respond to the call of the G7 to exclude Russia from the global financial system and to increase the costs to Russia and those who are supporting its war efforts.[40] The UN General Assembly has condemned Russia's annexation of parts of Ukraine, but sanctions have not followed largely as a result of Russia's veto in the Security Council which is the primary driver of UN action relating to peace and security.[41]

The broader purpose of financial sanctions is captured in guidance issued by the responsible UK government organisation, the Office for Financial Sanctions Implementation (OFSI) as follows:

'Financial sanctions are generally imposed to:

- coerce a regime, or individuals within a regime, into changing their behaviour (or aspects of it) by increasing the cost on them to such an extent that they decide to cease the offending behaviour;
- constrain a target by denying them access to key resources needed to continue their offending behaviour, including the financing of terrorism or nuclear proliferation;
- signal disapproval, stigmatising and potentially isolating a regime or individual, or as a way of sending broader political messages nationally or internationally; and/or
- protect the value of assets that have been misappropriated from a country until these assets can be repatriated.'[42]

From the perspective of public international law, sanctions are a form of collective action taken by members of an international organization against its own members, the classic example being UN sanctions adopted by the Security Council under Chapter 7 of the UN Charter. They can be distinguished from countermeasures which are unilateral actions or multilateral actions that are not collective actions by an organization. A countermeasure is an

consider the current and future consequences of the climate crisis. It ruled that inadequate climate policies today jeopardize the freedoms and fundamental rights of tomorrow (Germanwatch, 2021).

[40] G7 Leaders Statement on Ukraine, 19 May 2023 at https://www.whitehouse.gov/briefing-room/statements-releases/2023/05/19/g7-leaders-statement-on-ukraine/#:~:text=Since%20February%202022%2C%20we%20have,Russia%27s%20revenues%20are%20down.

[41] https://www.atlanticcouncil.org/blogs/ukrainealert/russias-veto-makes-a-mockery-of-the-united-nations-security-council/

[42] OFSI, UK financial sanctions: general guidance (August 2022) p7.

internationally wrongful act whose wrongfulness is precluded due to it being taken in response to a previous violation by the target state injuring the reacting state.[43]

While financial sanctions aim to limit access to financial services and markets they may be linked with broader economic sanctions, such as trade sanctions and shipping sanctions. Many types of financial activity typically fall within financial sanctions (including activities falling outside the regulatory perimeter) but in the light of the ISRC focus on capital markets, we focus our attention in this part on access to capital markets and related services for issuers and investors.

2.2 Financial sanctions: EU and UK

In the case of the EU and the UK, Brexit had the effect that the UK withdrew from the EU sanctions regime and put its own statutory regime in place.[44]

2.2.1 UK

2.2.1.1 The scope of financial sanctions

The scope of financial sanctions is defined by reference to persons and entities (including governments) and activities subject to sanctions. The persons and entities can be designated individually or by description (e.g., by reference to a connection with a particular country). The financial activities subject to sanctions are typically broadly defined. For example, in the UK to date they comprise asset freezes, investment bans, restrictions on access to capital markets, directions to cease banking relationships and activities, requirements to notify or seek authorisation prior to certain payments being made or received, restrictions on the provision of financial, insurance, brokering or advisory services or other financial services, and directions to cease all business.[45] Asset freezes are particularly important as they have the effect of preventing dealing in the relevant assets and making funds available to designated persons. Dealing is understood broadly and includes using, allowing access to or transferring the funds; dealing with the funds in any other way that would result in any change in volume, amount, location, ownership, possession or character of the funds; making any other change to the funds that would enable use in a different form.

The key provision within the UK regime is section 3 of SAMLA which empowers the making of regulations implementing sanctions against particular targets.[46] In addition to asset freezes, sanctions include other measures such as: preventing the supply of financial services to designated persons; prohibiting funds and economic resources being made available to designated persons; restrictions on commercial arrangements with designated persons; restrictions on ownership interests with designated persons; prohibiting the provision of funds or economic resources to designated persons. Although all these measures fall under the title ‘financial sanctions’ in SAMLA, they extend beyond activities falling within the regulatory

[43] See ‘Sanctions, Countermeasures and Human Rights’, Event Report at https://www.biicl.org/documents/238_sanctions_-_12_june_2014_-_event_report_final.pdf.
[44] The UK regime is mainly contained in the Sanctions and Money Laundering Act (‘SAMLA’) 2018 as amended by the Economic Crime (Transparency and Enforcement Act) 2022. Specific sanctions are implemented by statutory instruments made under powers contained in SAMLA. Around 3,000 individuals and entities are targeted by sanctions, some of whom are resident in the UK.
[45] OFSI, UK financial sanctions: general guidance (August 2022) p9.
[46] The UK Sanctions List provides details of persons subject to sanctions and the sanctions which have been imposed See https://www.gov.uk/government/publications/the-uk-sanctions-list.

perimeter for financial firms in the UK. This is reflected in the allocation of primary responsibility for oversight and enforcement of financial sanctions to OFSI (on behalf of HM Treasury), with the FCA having a supporting role in terms of oversight of the capability of financial firms to comply with sanctions. The UK regime includes an element of extraterritorial application in that it applies not only to all persons in the UK but also to all UK nationals and legal entities established under UK law, including their branches, irrespective of where their activities take place.

2.2.1.2 Reporting obligations

Reporting obligations are a key element of the financial sanctions regime in the UK. Regulated financial firms and various professions (including auditors and lawyers) are required to report to OFSI if they have reasonable cause to suspect that a designated person has committed an offence under the relevant regulations.

2.2.1.3 Enforcement and Sanctions

The UK sanctions regime provides for both criminal and civil (administrative) penalties for breaches of the regulations, including failure to report. OFSI has responsibility for civil penalties and can refer cases to the relevant authorities for criminal prosecution. To date, there have been some instances of substantial civil penalties but no prosecutions.

The broad scope of the UK sanctions regime and the central role of OFSI in oversight and enforcement means that the FCA has a secondary role in implementing the regime. Nevertheless, the FCA has a role in meeting its statutory objective of preventing financial crime and so exercises oversight of regulated firms' compliance with financial sanctions through its handbook provisions relating to governance.[47] An assessment of firms sanctions monitoring and compliance carried out by the FCA in 2023 identified several areas requiring improvement such as: the quality of information provided to senior management; global policies on sanctions not aligned with the UK regime: inadequate screening capabilities in respect of designated persons; failure of Customer Due diligence (CDD) and Know Your Customer (KYC) assessments to identify designated persons; and inconsistencies and delays in reporting breaches to OFSI (as well as to the FCA in the case of breaches that are also breaches of the FCA Handbook).[48]

2.2.2 EU

Overview: centralised adoption, decentralised application, EU oversight

The adoption of EU sanctions is set out in Articles 21 and ff. TEU on Common Foreign and Security Policy (CFSP). Sanctions have to be adopted by unanimity of MS (save in certain circumstances). The political agreement about the measures to be adopted is laid down in Decisions of the European Council, which are then specified by Council Regulations or are implemented by Member States (MSs).

Sanctions issued by Third Countries are not enforceable in the EU, however financial institutions are often attentive not to incur in their violation considering impact of the breach on their business and prudential soundness, in particular as regards US sanctions with extraterritorial effects. In this regard, the Commission has adopted a Delegated Regulation to block the extra-territorial application of these sanctions to EU national subjects within the sovereignty of the EU Member States. This Regulation, established with direct force of law in the Member States, prohibits compliance with Third Country sanctions. Apart from reporting duties, violations may trigger penalties and compensation claims. Market participants are confronted with complex compliance issues. In particular, it is a question whether the Blocking Regulations entails an obligation to enter into a contract affected by a Third Country sanction

[47] See FCA Handbook, Senior Management Systems and Controls (SYSC).
[48] https://www.fca.org.uk/publications/good-and-poor-practice/sanctions-systems-and-controls-firms-response-increased-sanctions-due-russias-invasion-ukraine

regime, or to refrain from termination thereof. The findings of a recent ECJ judgement (Bank Melli Iran vs. Deutsche Telekom[49]) are helpful, but there are open questions remaining.

The implementation of the sanction is decentralised and rests on MSs which have to adopt implementing measures, including criminal and/or administrative penalties for their breach. MSs have to designate an authority within their administration in charge of liaising with the European Commission. As clarified in an Opinion by the Commission, MSs cannot unilaterally adopt additional asset freeze measures on top of those adopted by the EU[50].

The Commission, in its capacity as guardian of the Treaty, is in charge of overseeing the correct application of the EU sanctions and may bring infringement procedures against MSs which fail to apply them. Given the decentralised application, uniform implementation has revealed to be an issue in the past.

From a legislative point of view, the adoption of the 2022 initial package of sanctions against Russia built up on previous sanctions adopted by Council Regulation (EU) 2014/269 and Council Regulation (EU) 833/2014, as a reaction of Russian's invasion of Crimea. specifically, Regulation 2022/259 amends Regulation 269/2014 on freezing of funds and economic resources of listed persons, as well as Regulation 2022/262, Regulation 2022/334, Regulation 2022/345 (targeting respectively the Central Bank of Russia and the government of Russia; the Russian aviation sector; the prohibition by certain Russian banks to participate to Swift and the provision of Euro banknotes to Russia) amend Regulation 833/2014 on restrictions on exports of certain dual-use goods and technology and on restrictions on access to the capital market for certain financial institutions.

With regard to Council Regulation (EU) N. 2022/269, such Regulation imposes **economic and financial restrictions** against the designated natural and legal persons listed in the Annex.

Restrictive measures are imposed by Article 2, providing for the freezing of assets '**owned, held or controlled'** "by any natural persons or natural or legal persons, entities or bodies associated with them as listed in Annex I shall be frozen".

The wording is broad since it covers both direct and indirect ownership, possession and control by natural or legal persons, entities, or bodies associated with them. By assets, the provision indicates "[a]ll funds and economic resources".

The same provision sets out an anti-circumvention requirement providing that "No funds or economic resources shall be made available, directly or indirectly, to or for the benefit of natural persons or natural or legal persons, entities or bodies associated with them listed in Annex I".

Such prohibition of circumvention is further reinforced in Article 9, providing that: "It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the measures referred to in Article 2". An exemption from responsibility is provided in article 10(2) providing that actions by EU operators do 'not give rise to any liability of any kind on their part if they did not know, and had no reasonable cause to suspect, that their actions would infringe the measures set out in the Regulation', including those in Article 2(2)".

[49] Bank Melli Iran v Telekom Deutschland GmbH (2021) ECJ ECLI:EU:C:2021:1035.
[50] Commission opinion on the compatibility of 8 November 2019 national asset freezes imposed by Member States with Union law, https://finance.ec.europa.eu/system/files/2020-01/191108-opinion-national-asset-freezes_en.pdf

The scope of economic and financial resources covered by the restrictive measures introduced by the Regulation is also broad, since it covers claims; contract and transactions; economic resources, freezing of economic resources; freezing of funds; funds.

Whilst the competence for implementation of sanctions rests at national level, cooperation and exchange of information between natural and legal persons that are bound by the application of the sanctions, the NCA designated by the MS, and Commission is expressly envisaged by Article 8(1), which provides that:

"Without prejudice to the applicable rules concerning reporting, confidentiality and professional secrecy, natural and legal persons, entities and bodies shall:

(a) supply immediately any information which would facilitate compliance with this Regulation, such as information on accounts and amounts frozen in accordance with Article 2, to the competent authority of the Member State where they are resident or located, and shall transmit such information, directly or through the Member State, to the Commission; […]"

The cooperation between MSs and the Commission requires each other to inform of the measures taken under the Regulation and share any other relevant information at their disposal in connection with this Regulation, in particular information.

In terms of jurisdictional application, the Regulation applies within the EU territory, on board of vessels and aircraft, against EU nationals also if abroad, against legal persons incorporated in the EU despite if abroad; transactions, any legal person, entity or body in respect of any business done in whole or in part within the Union.

In its oversight role, the Commission functions as a point of contact and of provision of harmonised interpretations, collection of best practices and responses to Frequently asked Questions. The package of sanction adopted against Russia and Belarus could rely on a body of soft law and practices quite developed and advanced. However, the European Commission has provided additional clarifications in the context of the various package of sanctions against Russia and Belarus in order to facilitate the uniform application at national level.

As illustrated in 2.1, increased focus on implementation and enforcement of sanction has been placed at EU level in the context of coordination and support with member states as well as with international working groups and intelligence. These initiatives have set-up the oversight and coordination role of the European Commission in the past limited to the publication of best practices and responses to Frequently Asked Questions (FAQ)[51] on the interpretation of sanction Regulations. Additionally, the violation of EU sanctions has been added to the list of EU crimes under Article 83(1) TFEU, which is also relevant to identify the money-laundering predicate offences.[52]

In respect of financial sanctions, both the European Securities markets Authority (ESMA) and the European Banking Authority (EBA) have also provided support to the uniform application of the sanction as a forum of discussion of critical issues with the national financial authorities and liaising with the Commission. Among other things, ESMA has for instance published a Statement on the effects of sanctions against Russia on the approval of a prospectus, clarifying, in liaison with the European Commission, that the infringement of EU sanctions may constitute

[51] https://finance.ec.europa.eu/eu-and-world/sanctions-restrictive-measures/sanctions-adopted-following-russias-military-aggression-against-ukraine_en#frequently-asked-questions

[52] For a summary of the process undertaken see https://www.consilium.europa.eu/en/policies/why-sanctions/#violation

a sufficient legal basis for the national competent authorities to refuse the approval of the prospectus.[53]

The EBA has acted on two levels: on the one hand has cooperated with the European Commission setting-up a Q&A system to channel questions on the interpretation of sanctions from the financial sector to the European Commission to facilitate the Commission FAQ initiative. On the other hand, the EBA has adopted Guidelines on the basis of Regulation (EU) N. 2024/1113 on Fund Transfer Regulation, to provide guidance on the internal policies, procedures and arrangements to be adopted and calibrated credit institutions to facilitate compliance with restrictive measures imposed via EU sanctions.[54] The focus has been placed on ensuring that institutions' screening systems are updated upon changes in the list of sanctioned natural and legal entities, that customer due diligence reflects the interaction with the lists of sanction persons, that transaction screening is calibrated to the business model (geographic outreach, targeted customers etc ...) of the institution and the exposure to sanction and risk violation. Specific Guidelines on compliance with EU sanctions have been adopted also in respect of Crypto-asset service providers and payment institutions, given the use of crypto-assets as means of transfer of funds outside the banking/payment channels. Although in terms of policies solution do not differ, i.e. calibrated transaction and customer due diligence screening having regard to the list of sanctioned persons, the geographic outreach of the business model, technical detail differ having regard to the different environment where CASPs operate.

The broad wording of the sanctions is confirmed by the broad interpretation of key notions by the European Commission which has an 'amplifying effect' on the scope of sanctions. As illustrated below, such broad concepts give rise to significant implementation challenges by financial institutions, requiring the adoption of specific compliance arrangements and procedures to detect designated entities and suspicious transactions.

In the European Commission's assessment, *if ownership or control are established, making funds available to the controlled (non-designated) entity is tantamount to making them available to the listed person.* The Commission does not make distinctions based on the place of incorporation of such subsidiaries, whether they are incorporated in a Member State or in a third country.

Additionally, making payments in favour of Third-Country Intermediaries for products originating from a non-EU entity which is controlled by a EU designated entity can be considered as making funds or economic resources indirectly available to the designated person, ie in breached sanctions.
The European Commission underscores that EU banks must apply due diligence mechanisms to ensure that processing a payment linked to an underlying transaction does not result in the indirect making available of funds to a designated person. By failing to comply with this obligation, the EU bank in question can be in breach of Article 2(2) of the Regulation. In

[53] See ESMA Public statement of 7 July 2022, available at https://www.esma.europa.eu/sites/default/files/library/esma32-384-5422_public_statement_prospectus_supervision_in_the_context_of_eu_sanctions_connected_to_rus_invasion_of_ua.pdf

[54] EBA, Consultation paper - Two sets of Guidelines on internal policies, procedures and controls to ensure the implementation of Union and national restrictive measures (2023) https://www.eba.europa.eu/sites/default/files/2023-12/55f8b825-dea4-48e9-82f4-f81a11cb4e47/Consultation%20paper%20on%20Guidelines%20restrictive%20measures.pdf

addition, the EU bank should inform the NCA and the Commission immediately, as required by Article 8 of the Regulation.

Article 9 of the Regulation prohibits all EU operators, including banks, from participating, ‘knowingly and intentionally, in activities the object or effect of which is to circumvent the measures referred to in Article 2’ of the Regulation’. However, such elements are without prejudice to Article 10(2) of the Regulation, which establishes that actions by EU operators do ‘not give rise to any liability of any kind on their part if they did not know, and had no reasonable cause to suspect, that their actions would infringe the measures set out in the Regulation’, including those in Article 2(2).

2.3 USA

US autonomous sanction practices frequently include extraterritorial effects on non-US jurisdictions. Such effects may be included in the US Specially Designated Nationals and Blocked Persons list (SDN-list) which results in prohibition of any business relationship with the blocked entity with worldwide effect, even if such relationship does not affect the USA and/or is not governed by US law according to the principles of International Private Law. In case of violations third country entities may be added to the SDN list. Even the use of the US Dollar as a payment currency can be regarded as a sufficient link with the USA to trigger secondary sanctions. They may further include prohibition of transactions involving blocked property including property of sanctioned central banks. The extraterritorial effect of the Russia-related US sanctions regime has been significantly intensified with a compliance note issued jointly by the US BIS and the US OFAC on March 2, 2023, titled “Cracking Down on Third Party Intermediaries Used to Evade Russia-related Sanctions and Export Controls”. The aim is to prevent circumventions.

3. Digital finance

3.1. Background and context

It is often said that regulation is a moving target since it needs to anticipate or adapt to ever changing market and economic conditions. This section of the Report focuses on technology, and in particular on digital finance.

Despite the recent rise of technology as significant driver of regulatory changes, digital finance – which relies more on advanced blockchain technology– is shifting the attention away from the financial technology (‘FinTech’). The fast growth, interest of BigTech (Facebook Libra and then Diem projects) in stablecoins, ease of upscaling and intrinsically international nature of the crypto-asset business soon attracted the attention of global standard setters, in particular the Financial Stability Board (FSB) and the International Organisation of Securities Commissioners (IOSCO). Prompt reaction has stemmed from the interests at stake, including monetary sovereignty, financial stability, fragmentation of payment systems and consumer protection.

However, regulating such phenomena poses several challenges such as the complexity of new technology and regulatory dilemmas including the appropriate timing to regulate (not too early when the business and the technology is not sufficiently known, not too late since it would be ineffective to prevent crisis and protect investors), which should combine and weigh the various public interests at stake.

Accordingly, international standard setters have endorsed the principle of ‘technology neutrality’ at the basis of FinTech regulation, also in respect of digital finance. This principle entails the absence of preference between traditional and innovative delivery mechanisms, rather that regulation is risk-based and that the same risks call for the same regulatory solutions. This is clearly stated in the FSB documents, starting from the 2020 High Level recommendations for ‘Global Stablecoins’ arrangements, to the more recent comprehensive documents on the framework for crypto-assets activities (17 July 2023). Other documents focus on the financial stability risks of crypto-assets (2022), of decentralised finance (2023) and of multi-function crypto-asset intermediaries (2023).

The FSB 2020 High level recommendations for global stablecoins drew attention on several aspects, the first on the importance to bring such arrangements within the scope of regulation, hence the need to enact a legislative framework including the establishment of authorities adequately empowered. To complement this, the recommendations signal the importance of international cooperation. Regarding the regulation of the issuer, the recommendations focus on the need for effective governance arrangements, including fitness and propriety of the members of the board of directors and shareholders with qualifying holdings, effective risk management of the reserve of assets, adequate ICT risk management to ensure operational resilience and cyber security, reporting, storing and safeguarding data; and arrangements to counter ML/TF risk. Recommendations also focus on adequacy and effectiveness of the rights of token holders, including disclosure requirements on the functioning of the stabilisation mechanism, and plans to ensure redemption rights.

The collapse of stablecoin US Terra and Luna in May 2022, followed by the filing for bankruptcy of FTX (the world’s second largest cryptocurrency exchange, which was once valued in excess of thirty billion dollars) in December 2022 further increased the regulatory response. A review of the High level Recommendations for global stablecoins was launched and finalised in July 2023, to further underscore the importance of internal governance arrangements, ownership structures, effectiveness and stability of stabilisation mechanisms and the inconsistency of pure algorithmic mechanisms. Similarly in 2023, IOSCO issued a comprehensive document laying down policy recommendations on crypto and digital assets markets (2023), focusing on conflicts of interests from vertical integration; market manipulation, insider trading, fraud; custody and client protection; cross-border risks and regulatory cooperation; operational and technological risks; retail distribution.

Such crashes, and in particular the demise of FTX Crypto Exchange in 2022 damaged the crypto sector’s reputation and market, which shrunk by 2/3 between November 2021 and July 2022. Whilst such events have heightened the need for greater regulation of the sectors, others have claimed that regulation would give credibility to a financial business which has no link with the real economy and which has significant environmental impact energy consumption. The EU has been the first mover to ‘fill the gap’ and adopt a holistic approach to the regulation and supervision of crypto-asset activities that are not already covered by EU law. Following the submission of a proposal in September 2020, the Regulation on Market in crypto-assets (‘MiCAR’, Regulation (EU) 2023/1114) has been finalized at the end of 2022 and published in June 2023.

Regulatory initiatives have been undertaken also by the UK, including a proposal to include stablecoins within the regulatory perimeter with a view to integrating them into the payments system.

In the US, the Securities Commission recently approved a number of spot bitcoin exchange - traded products ("ETPs") shares for listing and trading.[55] It however clarified that it did not approve or endorse bitcoin and that investors should remain cautious about the risks associated with bitcoin and its products whose value is tied to crypto.

3.2. **EU issues**

MiCAR sets out a framework for the regulation and supervision of issuers of crypto-assets and of crypto-asset service providers ('CASPs'). However, in accordance with the principle of technology neutrality and 'same risks, same regulation', it only applies to those crypto-assets which are not covered by other EU regulations. Therefore, if the assets fall within the definition of 'financial instruments' set out in MiFID, it will be subject to that regime; similarly, if it falls within the notion of deposit set out in the Directive 2014/49/EU on Deposit guarantee scheme it will be covered by Directive 2013/36/EU on credit institutions. Central bank digital currencies – if and when they will be issued – will also be outside the scope of application of MiCAR.

Under MiCAR 'crypto-assets' are defined as a digital representation of a value or a right which may be transferred and stored electronically, using distributed leger technology or similar technology.

Stablecoins are types of crypto-assets, however MiCAR does not use the term 'stablecoin' which is considered a marketing notion but refers to asset-referenced tokens ('ARTs'), and to e-money tokens ('EMTs').

ARTs are crypto-assets which maintain a stable value by referring to several fiat currencies, one or several commodities or one or several crypto-assets or a combination of such assets. EMTs are crypto-assets which maintain a stable value by referring to the value of one fiat currency.

As a general overview, MiCAR sets out requirements for issuers all types of crypto-assets falling within its scope of application. Such requirements vary depending on the token and the type of issuers. Whilst issuance of ARTs or EMT is significantly regulated, issuance of other crypto-assets is exclusively subject to the notification of a 'white paper' (a sort of prospectus) to the authority and to the requirement that the issuer has to be a legal entity.

Issuance of ARTs is reserved to legal entities or other undertakings or credit institutions established in the EU. Legal entities or other undertakings have to be granted an authorisation to offer to the public or seek admission to trading of ARTs have the white paper approved. Conversely, credit institutions do not need an additional authorisation, however they have to seek approval of the white paper and submit a number of information on internal governance and ICT risk management and operational resilience to the authority.

[55] CG Gensler, Statement on the Approval of Spot Bitcoin Exchange-Traded Products (10 January 2024) https://www.sec.gov/news/statement/gensler-statement-spot-bitcoin-011023

EMTs may only be issued by credit institutions or e-money institutions authorised in accordance with the applicable EU legislation.

To ensure stability to the token, ARTs have to be supported by a stabilisation mechanism and the related reserve of assets have to be held in custody segregated by the other assets of the issuer. Their composition and investment are also regulated.

EMTs are issued at par and are guaranteed by safeguard funds in accordance with the E-money Directive.

Token holders of ARTs or of EMTs have a permanent right of redemption against the issuer, and in the case of ARTs, against the reserve of assets when the issuer is no longer able to fulfil its obligations. To ensure the orderly redemption of the tokens, issuers have to develop a redemption plan.

Considerable relevance is placed on the protection of token holders both at the moment of the offer to the public or admission to trading, where the issuer is requested to publish an approved white paper and in going concern where the issuer is subject to disclosure requirements on the functioning of the stabilisation mechanism, including the value and composition of the reserve of assets.

ART or EMT issuers are subject to the supervision of the national authority, or when they issue 'significant’ tokens they become subject to the supervision of the European Banking Authority (EBA), which is supported by a college of supervisors.

ARTs or EMTs are considered significant when they meet certain criteria in terms of large customer base, high market capitalisation or large number of transactions executed. Considering the challenges posed to financial stability, monetary policy transmission or monetary sovereignty, such tokens are subject to more stringent requirements, including additional higher capital, interoperability requirements, liquidity management policy.

The provision of services relating to crypto-assets is reserved to crypto-asset service providers authorised in accordance with MiCAR or, in case of investment firms, credit institutions or CCPs subject to a prior notification to the authority. The identification and regulation of services to be provided by CASPs is modelled after MiFID.

Crypto-asset services are:

- custody and administration of crypto assets on behalf of clients;
- operation of trading platform;
- exchange of crypto-assets for funds;
- exchange of orders for crypto-assets on behalf of clients;
- execution of orders for crypto-assets on behalf of clients;
- reception and transmission of orders for crypto-assets on behalf of clients;
- provision of advice on crypto-assets;
- provision of transfer services for crypto-assets on behalf of clients.

The provisions set out in MiCAR are directly applicable within the national law of the Member States and are being complemented by implementing Regulations developed by the EBA, in respect of the issuers, and by the European Securities Market Authority (‘ESMA’), for CASPs.

At the expiration of the transitional period on 30 June 2024, MiCAR will become applicable to issuers as at that date issuers of stablecoins, be they subject to national law or be unregulated, will have to be compliant with the provisions applicable to ARTs or EMTs, notably concerning the mandatory authorisation (where applicable) and the approval of the white paper. To facilitate the smooth transitioning from domestic regulation or lack of regulation, to the application of MiCAR, the EBA has adopted a Statement suggesting the application of MiCAR by design, via the identification of guiding principles that are recommended to be complied with. Exchange and submission of information to the competent authority is also recommended and a template is included in the Statement.

Regarding CASPs, MiCAR leaves the option for a longer transitional period, between 30 December 2024 and 1st July 2026. To avoid arbitrage opportunities in the course of the transitional period and to support an adequate transition also in the interest of investors, ESMA issued a Statement on 17 September 2023 calling entities currently providing services related to crypto-assets to inform authorities and clients of their transition plans, to apply MiCAR provisions by design prior to their entry into application and to apply for authorisation as soon as possible, also having regard to cross-border intra-EU activities that are covered by the license.

By way of conclusion of this short overview, the Regulation aims to strike a balance between technology progress, protection of financial stability, monetary policy transmission, smooth functioning of payment systems and consumer protection. It has attracted significant attention by market operators and other jurisdictions. Even more than other areas, regulation of this ecosystem is a moving target and MiCAR is the first piece. It does not purport to govern the whole crypto ecosystem, but just the financial services carried out on the distributed ledger. The operation of blockchain is outside its scope. Similarly, fully decentralised finance and central bank digital currency are not captured and will be covered by separate legislation.

3.3. **UK Issues**

The UK's initiative to regulate stablecoin issuance and payments reflects concern that there are firms outside the regulatory perimeter that may wish to offer innovative payment services and systems using new tokenised forms of digital money, such as stablecoins. Such coins would likely be used primarily for retail payments but could also be used for investment purposes. A dual regulation regime is proposed with the FCA being responsible for non-systemic stablecoins (both prudential and conduct aspects) and the Bank of England for systemic stablecoins. The Bank's regime for systemic payment systems using stablecoins is intended for payment system business models that do not involve the payment system or the coins taking credit, liquidity or market risk and which generate revenues from payment services rather than liquidity and maturity transformation. Firms that want to use the funds received from customers to undertake maturity transformation should seek authorisation as banks and be regulated accordingly under the PRA's existing banking regime. Firms that provide stablecoins with claims of variable value would not be suitable for the Bank's proposed regime.[56]

3.4. **The Caribbean**

The Caribbean has become an attractive option in the global crypto market and various crypto regulatory regimes have developed. Bermuda, the British Virgin Islands (BVI), Cayman

[56] See generally *https://www.bankofengland.co.uk/paper/2023/cross-authority-roadmap-on-innovation-in-payments*

Islands and the Bahamas have frameworks in place for the regulation and supervision of virtual assets.

In Bermuda, the Digital Asset Business Act, 2018 introduced a regime for businesses seeking to conduct any of the following digital asset activities:

- issuing, selling or redeeming virtual coins, tokens or any other form of digital assets
- operating as a payment service provider business utilising digital assets
- includes the provision of services for the transfer of funds
- operating as an electronic exchange
- providing custodial wallet services
- operating as a digital assets services vendor

The licensing regime also includes AML, cybersecurity, prudential and market conduct requirements. The Bermuda Digital Assets Issuance Act, 2020 regulates persons seeking to carry out a virtual asset issuance.

In the BVI, the Virtual Assets Service Providers Act, 2022 ("the VASP Act"), creates the legal framework for the registration and supervision of Virtual Assets Service Providers (VASPs) providing a virtual asset service operating in and from within the Virgin Islands. The features of the VASP Act includes:[57]

- details of the application and approval requirements for registration as a VASP, including additional specific requirements for VASPs seeking to provide virtual assets custody services or operate a virtual assets exchange;
- the requirement for VASPs to appoint authorised representatives;
- particulars of the functions of an authorised representative and the requirement for authorised representatives to be approved by the Commission to act in relation to VASPs;
- the requirement for VASPs to appoint an auditor approved by the Commission and the obligations of the auditor to the Commission;
- details of the information that a registered VASP must report to the Commission on an ongoing basis;
- the process to be adopted for disposing or acquiring a significant or controlling interest in a VASP;
- the establishment of measures to protect clients' assets;
- prohibitions on making or issuing misleading advertisements;
- AML/CFT and other regulatory compliance matters; and
- the legal mechanism for a VASP to participate in the Regulatory Sandbox.

In the Cayman Islands, the Virtual Asset (Service Providers) Act (as amended, the VASP Act) provides the framework for the conduct of virtual asset business in the Cayman Islands and for the registration and licensing of persons who are providing virtual asset services.

In 2020, The Bahamas enacted the Digital Asset and Registered Exchanges (DARE) Act, which regulates Bahamas-based entities involved in the issuance, sale, and exchange of digital assets. In 2023, the Securities Commission of the Bahamas commenced a consultation process on new DARE legislation to strengthen the legislative framework for digital asset businesses in view of the FTX collapse.

3.5. **IOSCO**

[57] https://www.bvifsc.vg/news/industry-updates/virtual-assets-service-providers-act-2022

The IOSCO Policy Recommendations for Crypto and Digital Asset Markets included in its Final Report of November 16, 2023 ("IOSCO Report")[58] seek to support greater consistency with respect to regulatory frameworks and oversight in IOSCO member jurisdictions and address concerns related to market integrity and investor protection arising from crypto-asset activities. These recommendations as stated in the IOSCO Report cover:

1. Conflicts of interest arising from vertical integration of activities and functions - Crypto-asset service providers ("CASPS") are required to have effective governance and organizational requirements in place to effectively address and mitigate issues on conflicts of interests arising from vertical integration, including the possible need for measures such as legal segregation of functions and activities, as well as separate registration. As noted in the IOSCO Report, this recommendation takes into consideration that many CASPs typically engage in multiple functions and activities under 'one roof' – including exchange trading, brokerage, market-making and other proprietary trading, offering margin trading, custody, settlement, and re-use of assets – whether through a single legal entity or an affiliated group of entities that are part of a wider group structure.

2. Market manipulation, insider trading and fraud - there should be effective systems and controls to identify and monitor for manipulative market practices and to prevent leakage and misuse of inside information.

3. Cross-border risks and regulatory co-operation - IOSCO members should adopt best practices for international co-operation to help ensure effective supervision and enforcement.

4. Custody and client asset protection - to help ensure that where client monies and Assets are held by CASPs, they are held safely, and transferred securely, and that inappropriate mixing of assets and other potential abuses are avoided.

5. Operational and technological risk – to address the broad spectrum of operational risks that can arise because of lax controls at CASPs combined with the risks related to DLT and smart contracts.

6. Retail access, suitability, and distribution -ensure that existing or new regulations require CASPs to diligently assess and onboard retail investors who are aware of, and deemed suitable to take on, the greater speculative risks inherent in this market, and to use appropriate measures when promoting crypto-assets to this population, including if crypto-assets are promoted on social media.

4. Market access and listing regimes

4.1. Background and context

Listing regimes have responded to several key issues that are relevant for access to capital markets in recent years: the regulatory complexity and associated cost of accessing capital markets; the potential for entrepreneurs to retain control after a public offer through mechanisms such as dual class shares; and the conditions attached to foreign listing by the home and host state of companies respectively. All these factors are linked to the role of capital

[58] See https://www.iosco.org/library/pubdocs/pdf/IOSCOPD747.pdf

markets in supporting innovation and entrepreneurship and in this final section we consider some recent important developments.

4.2. **EU Listing Act Package**

In December 2022, the European Commission introduced three interrelated proposals as part of the Listing Package. This is part of the Capital Markets Union (CMU) initiative, launched in 2015 to facilitate access to market-based financing for EU companies.

- Proposal for a regulation amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises: the amendments to the Prospectus Regulation aim to make it easier and cheaper for issuers to draw up a prospectus, providing comprehensible, easy to analyse and concise information to enable investors to make the right investment decision. . They also seek to introduce sizable simplifications to, or even exemptions from, the prospectus requirements in cases where the issuer is already known to investors and a lot of information is already publicly available (follow-on issuances). Other amendments aim at fostering the convergence and streamlining of the scrutiny and approval process by NCAs (for example, by narrowly framing the ability of NCAs to request issuers to include additional information in the prospectus).
- Proposal for a directive amending Directive 2014/65/EU to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises and repealing Directive 2001/34/EC. Such amendments seek to facilitate the development and provision of investment research on companies (especially small and medium capitalisation) and to further incentivise the attractiveness of the SME growth market regime, facilitating access to capital markets in turn. Furthermore, it aims to provide a framework for developing a particular type of research that is paid by the issuer ('issuer-sponsored research').
- Proposal for a directive on multiple-vote share structures in companies that seek the admission to trading of their shares on an SME growth market. It should address the regulatory barriers that emerge at the pre-IPO phase and provide EU companies with equal opportunities to choose the appropriate governance structures when listing. Furthermore, the proposal aims to standardize national laws and enable listed company owners to raise more funds while retaining specific voting rights. Specifically, it enables founders and owners to maintain control over their companies when accessing public markets, allowing them to pursue long-term strategies.
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The proposals, which were adopted by the last Plenary session of the current configuration of the European Parliament, in April, aim to enhance access to stock markets, particularly for SMEs, streamline the listing process, striking a balance between regulatory requirements and compliance costs for companies considering or already engaged in listing activities, while ensuring adequate investor protection and market integrity.

The directives focus on several key stages:

- Pre-IPO, by aiming to ease the creation and provision of investment research while addressing inherent conflicts of interest;
- IPO: Efforts concentrate on simplifying and reducing costs associated with preparing prospectuses;
- Post-IPO, by providing clearer guidelines on identifying inside information.

Overall, the Listing Act could represent a significant step toward improving the attractiveness of EU listing for companies.

4.3. UK Review of Listing Rules – innovation and competitive impact

The UK Listing Review in 2021 (aka the Hill Review) focused attention on the relative decline that was evident in London's share of global listings and share trading in the previous decade. Brexit brought some additional concerns to this agenda but at the same time opened up the opportunity for the UK to consider some reforms that differed from the approach in the EU. A range of issues were considered in the review and some have already been the subject of regulatory reform. A key issue, linked to a long-standing difference of approach between regulators and institutional investors in London and other global capital markets, was that of dual class shares.

Dual class share structures ('DCSS') exist when different classes of shares carry different voting rights, with the result that there are differences between the economic interests and voting rights of investors according to the shares they own. These structures have grown in significance in recent years, in particular as a technique to entrench the control of founders when innovative companies (especially in the 'tech' sector) list on public markets. While UK company law is permissive in its approach to DCSS, institutional investors in the UK were in the past generally supportive of the principle of 'one share one vote' and therefore opposed to DCSS as a matter of principle. While the basis for that policy was never clearly articulated, it was reflected in the listing principles for premium listed companies, which limited companies with DCSS to a standard listing in London.

However, the increasing acceptance of DCSS in other important capital markets and the perception that the UK stance was discouraging listing in London prompted a review of the UK position. The Hill Review proposed that DCSS be permitted in the premium listed segment subject to conditions and that approach was given effect by changes to the listing rules which took effect in December 2021. However, there are strict conditions attached to the type of DCSS that is permitted. In particular: the high vote shares must be unlisted and held only by directors; the DCSS can last for only five years; high vote shares are limited to 20 votes per share; and weighted voting applies only in the case of resolutions to remove a director or a shareholder resolution required by the listing rules after a change of control. The limitations on weighted voting both entrench the directors and deter takeovers during the period that the DCSS operates.

The relaxation of the listing rules to permit DCSS in the premium segment clearly has the effect of facilitating effective control by directors, albeit for a limited period of time. While that represents a reversal of the earlier UK position that DCSS had a negative impact on the quality of corporate governance, both empirical evidence and the toleration of DCSS in other major markets suggest that the earlier UK stance was misguided. That view is reflected in the recent proposals from the FCA to further liberalise dual class shares in the proposed single listing category (replacing the current premium and standard segments). That move would place the UK at the more liberal end of global capital markets with regard to dual class shares.

4.4 China's New Practice – the New Rules for the filing of overseas securities issuance and listing by PRC domestic enterprises

4.4.1. The Release of the New Rules on Overseas Listing

On February 17, 2023, the China Securities Regulatory Commission (the "CSRC") promulgated the Trial Administrative Measures of Overseas Securities Offering and Listing by Domestic Companies (the "Trial Measures") and five supporting guidelines for the application of the regulatory rules for the overseas offering and listing (the "Supporting Guidelines", together with the Trial Measures, collectively referred to as the "New Rules"). Such New Rules came into force on March 31, 2023.

4.4.2. Changes Brought by the New Rules

- Full Inclusion of the Direct and Indirect IPO into Domestic Supervision

The Trial Measures classifies overseas offering and listing by domestic enterprises into "direct overseas offering and listing" and "indirect overseas offering and listing". Among them, "direct overseas offering and listing by domestic enterprises" refers to overseas offering and listing by joint stock limited companies which are registered and established in China; "indirect overseas offering and listing by domestic enterprises" refers to overseas offering and listing by domestic enterprises whose main business activities are conducted in the name of the overseas registered enterprises based on their equity interests, assets, income or other similar rights and interests. One of the most prominent changes of the New Rules is that the Trial Measures has unified the two kinds of IPO application methods (direct and indirect) into the rules.

- The filing of overseas listing adopts the negative list system

The filing of overseas listing of a domestic enterprise adopts a negative list approach. Under circumstances including where financing by listing is expressly restricted or prohibited under the laws, administrative regulations and relevant provisions of the state in the fields of industrial policy, etc., the overseas listing shall not be allowed.

4.4.3. Key Concerns of the Filing Examination of Overseas Listing

- Examination and Approval of Filing with CSRC on Shareholding Structure

The relevant information of issuers' shareholders and actual controllers shall be explained in the filing report submitted to the CSRC.

CSRC Filing Reviews of Business Compliance

The approval and examination on business compliance after filing with CSRC tend to be more consistent with the requirements on companies in A-shares listings.

- Filing Requirements for Overseas Listing of Companies with VIE Structure and De-SPAC Listed Companies

With respect to the overseas listing conducted by contractual controlling (Variable Interest Entity, or "VIE") structure, the New Rules provides that a domestic company that seeks to list its domestic assets through VIE structure shall fulfil the filing procedure.

The key points of CSRC's review on VIE structures include: (1) the reasons for the establishment of the agreement control structure and the specific arrangements; (2) the risks that may arise from the agreement control structure in respect of control, default of the relevant entities, taxation and other risks; and (3) the arrangements for risk countermeasures.

To make it clear, China has not yet explicitly clarified the legal status of VIE structures through legislation, nor has it outright prohibited VIE listings. The New Rules have brought under the ambit of the CSRC's filing supervision both direct and indirect overseas issuance of securities and listings by domestic companies, including those utilizing VIE structures. There are precedents mentioned above where the filing process for VIE structures has proceeded smoothly as a reference. The legal validity of VIE structures within China remains an issue to be observed in practice.

4.4.4. Observations after the New Rules on Overseas Listing: the rules for H-share Full Circulation and the amendments for the HKEx Listing Rules

- Amendments to the Rules on the Full Circulation of H-shares

In order to change the regulation of the full circulation from the licensing system to the record-filing system after the full implementation of the filing system for overseas listing under the New Rules, the CSRC revised the Guidelines for the Application by H-share Companies for "Full Circulation" of Unlisted Shares on August 10, 2023. Enterprises may simultaneously complete the filing for the full circulation when applying for the filing for overseas listing or apply for the full circulation filing separately after completion of the overseas listing.

- Amendment to the Listing Rules of the Hong Kong Stock Exchange

On July 21, 2023, the Hong Kong Stock Exchange published a Consultation Paper on the Rule Amendments Following Mainland PRC Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers, which formally amended the Listing Rules, aiming to respond to the recent changes in the Mainland PRC regulatory rules, bring the requirements applicable to PRC issuers under the Listing Rules and bring them in line with those applicable to other offshore issuers, simplifying the requirements for PRC applicants and PRC issuers and giving issuers more flexibility in respect of their share issuance and share planning. The above amendments have taken effect as of August 1, 2023.

4.4.5. Conclusion

The promulgation and implementation of the PRC's New Rules indicates that the regulatory system for overseas listing and issuance of shares by domestic enterprises has officially stepped into a new era of a comprehensive filing system and has cleared up a lot of regulatory gaps previously. For many domestic enterprises who intend to go public on overseas listings, the cost of going public may be increased; however, with clearer filing path and procedures, there will be more certainty for domestic enterprises when going public on overseas listings.
However, compared to the disclosure obligations in other countries, China's requirements may be more stringent. There has been a gradual and phased evolution in the scope and intensity of Chinese regulatory content, and for overseas listings, it is essential to pay close attention to the issues of concern to regulators and engage in more effective communication.

5. Conclusions

The matters covered in this report are indicative of the central role of capital markets in the development of policy linked to sustainability and the digital economy in particular. Differences in national regulatory regimes facing similar risks emphasise the need for interoperability and the evolution of common standards. A similar observation can be made as between the approaches adopted by banking, capital markets and insurance regulators. AI represents a good example of the challenges, with the AI Act in the EU already representing a more regulatory focused approach than is evident elsewhere.

Within capital markets challenges remain in terms of setting the appropriate balance between competitiveness and investor protection and in opening up access to capital, especially as a technique to promote innovation and economic growth. This is particularly the case for the EU's capital markets union, which has to date lagged behind its full potential. Greenwashing remains a pressing concern for regulators and merits further study as a technique to enable capital markets to fulfill their envisaged role as conduits for sustainability. Litigation and liability risk linked to sustainability for companies, investors and regulators is also an issue that is rising in prominence and merits further attention from the ISRC.

In recognition of the need for further study and discussion on these issues, the Committee proposes that its remit be extended.
[END OF REPORT]