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UK FINANCIAL SERVICES AND MARKETS BILL: ENACTING THE FUTURE REGULATORY FRAMEWORK

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The new UK Financial Services and Markets Bill aims to implement the outcomes of the government's future regulatory framework review and to make other changes to update the UK regulatory regime.

The Bill would revoke retained EU law on financial services and give HM Treasury broad powers to make regulations restating and revising that law and designating other activities for regulation by the UK regulators. It would also make changes to the UK regulators' objectives and the mechanisms for their accountability.

In addition, the Bill would implement the outcomes of other reviews, including the reviews of the regulation of wholesale markets, financial market infrastructure, digital settlement assets, critical third-party service providers, financial promotions and access to cash and of the regimes for central counterparties and insurers in financial difficulties. It also would give HM Treasury new powers to implement mutual recognition arrangements with other countries and modify the rules for approving changes in control of authorised persons.

The Bill and the government's explanatory notes are available **here**.

What was the future regulatory framework review?

The UK ceased to be treated as an EU Member State for the purposes of EU law on 31 December 2020. The European Union (Withdrawal) Act 2018 (EUWA) ensured the continuity of EU law in the UK after that date by 'onshoring' then existing EU law as part of UK law, subject to amendments to ensure that it continued to work effectively in the UK.

However, this process resulted in a complex patchwork of 'retained EU law', comprising onshored EU regulations, technical standards and decisions and domestic legislation and rules implementing EU law, all as amended by 'exit instruments' under the EUWA - much of which cannot now be changed without the authority of a new Act of Parliament. This constrains how the UK regulators can pursue their statutory objectives through their rules and restricts the ability of the government and regulators to adapt the UK regulatory regime in response to changing circumstances.

Key issues

- Implements the outcomes of the future regulatory framework review
- Revokes, replaces and revises EU-derived legislation on financial services
- Creates a new designated activities regime
- Changes the regulators' objectives and accountability mechanisms
- Allows HM Treasury to implement international mutual recognition arrangements
- Implements outcomes of the wholesale markets review
- Gives the Bank of England and FCA new powers over financial market infrastructure
- Creates a regime for the oversight of critical third party service providers
- Gives new powers to regulate 'digital settlement assets'
- Provides new powers over the cash access and wholesale cash industry
- Replaces the cash ratio deposit scheme with a new Bank of England levy
- Updates the regime for insurers in financial difficulties
- Allows PSR to require customer reimbursement for authorised push payment scams
- Requires firms to have specific permission to approve financial promotions
- Extends the powers to impose conditions on changes in control of authorised firms

In June 2019, the then Chancellor of the Exchequer launched a review of the future of the UK regulatory framework. This was followed by a series of consultations and the interim step of the Financial Services Act 2021 to address some immediate issues.

The Bill largely reflects the proposals set out in the latest consultations. The proposals aim to adapt retained EU law on financial services and build on the existing approach to UK regulation under the Financial Services and Markets Act 2000 (FSMA), which gives the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) broad powers to make rules within a framework set by Parliament and the government.

How would the Bill revoke, replace and revise retained EU law?

The Bill would revoke all 'EU-derived legislation' relating to financial services and markets, including 32 specified EU regulations, 189 specified statutory instruments and all provisions made under 25 specified EU directives. However, it would not generally repeal retained EU law embedded in UK primary legislation.

'EU-derived legislation' means: any EU regulation or decision 'onshored' under the EUWA; any secondary legislation implementing any EU directive or EU Treaty obligation; and any secondary legislation made under the EUWA or under the proposed transitional power to modify legislation being revoked by the Bill (but does not include rules made by the regulators).

Any right, powers, liabilities, obligations, remedies and procedures recognised or available in domestic law by virtue of the EUWA derived from any revoked legislation would also cease to be recognised or available in domestic law.

EU-derived legislation would continue to apply for a transitional period until HM Treasury brings the revocation into force in relation to that legislation. However, the Bill would:

- make some immediate changes to that legislation in relation to the transitional period (see below);
- give HM Treasury powers to make regulations further modifying that legislation (other than technical standards) as it applies in relation to the transitional period (to address new circumstances or policy priorities arising before the legislation can be revoked, replaced and revised);
- give HM Treasury powers to restate that legislation (other than technical standards) so that it continues to apply, with or without further modifications, after the end of the transitional period (in the form of amendments to primary or secondary legislation or as new stand-alone regulations);
- give HM Treasury continuing powers, after the end of the transitional period, to make regulations modifying any restated legislation, including where that legislation has been restated as part of primary legislation;
- give HM Treasury powers to modify any legislation to replace references to specified EU directives with other appropriate provisions.

What EU-derived legislation would be revoked?

Specified 'Level 1' EU regulations	Provisions made under specified 'Level 1' EU directives
Markets	
• Credit rating agencies (1060/2009, 513/2011 and 462/2013) • Short selling and credit default swaps (236/2012) • European market infrastructure (648/2012) • Market abuse (596/2014) • Markets in financial instruments (600/2014 and 2016/1033) • Central securities depositories (909/2014) • Securities financing transactions (2015/2365) • Benchmarks (2016/1011) • Prospectuses (2017/1129) • Securitisation (2017/2402) • Sustainability-related disclosures (2019/2088) • Sustainable investment framework (2020/852)	• Settlement finality (98/26) • Listing (2001/24) • Financial collateral (2002/47) • Transparency obligations for issuers (2004/109) • Criminal sanctions for market abuse (2014/57) • Markets in financial instruments (2014/65)
Bank and investment firm prudential	
• Capital requirements for credit institutions and investment firms (575/2013, 2017/2401, 2019/630 and 2019/876	• Credit institutions winding up (2001/24) • Financial conglomerates (2002/87 and 2011/89) • Capital requirements for credit institutions and investment firms (2013/36) • Deposit guarantee schemes (2014/49) • Recovery and resolution of credit institutions and investment firms (2014/59) • Prudential supervision of investment firms (2019/2034)
Insurance	
	• Motor vehicle insurance (2009/103) • Solvency II (2009/138) • Insurance distribution (2016/97) • Institutions for occupational pension provision (2016/2341)
Payments	
• Cross-border payments (924/2009) • Credit transfers and direct debits in euro (260/2012 and 248/2014) • Interchange fees for card-based payments (2015/751)	• Electronic money (2009/110) • Payment accounts and comparability of fees (2014/92) • Payment services (2015/2366)

Funds	
• European venture capital funds (345/2013) • European social entrepreneurship funds (346/2013) • Long-term investment funds (2015/760) • Money market funds (2017/1131)	• UCITS (2009/65) • Alternative investment fund managers (2011/61)
Retail	
• Packaged retail and insurance-based investment products (1286/2014)	• Distance marketing of consumer financial services (2002/65) • Consumer credit (2008/48) • Mortgage credit (2014/17)
Other	
• Money market statistics (2019/113) • Supervisory fees (2019/2155) • European supervisory authorities (2019/2175) • Reporting of supervisory information (2020/605)	
Other revocations	
• 189 specified statutory instruments (including instruments implementing the specified EU legislation and other EU legislation and exit instruments adopted under the EUWA) and all provisions made under those instruments; • All binding technical standards which apply in the UK; • Specified provisions in FSMA (including those relating to the making of technical standards and the PRA's CRR rules) but not any other primary legislation; • Any other EU-derived legislation so far as relating to financial services and markets (unless excluded by regulations made by HM Treasury).	

EU-derived legislation would continue to be treated as 'retained EU law' under the EUWA until it is revoked. Thus, it would continue to be interpreted in accordance with retained EU-case law and general principles of EU law (at least to the extent unmodified) and would continue to have its residual supremacy over Acts of Parliament made before 1 January 2021. However, the Bill provides that any restatement of that legislation applying after the end of its transitional period would not be 'retained EU law'. Thus, restated law may be interpreted differently from the predecessor EU-derived legislation even if expressed in the same terms.

HM Treasury would be able to use the powers conferred by the Bill to modify legislation for a wide range of policy purposes, including to protect financial stability, promote competition, facilitate the UK economy's international competitiveness and growth and protect consumers and insurance policyholders. It would also be able to use those powers to restate legislation in a clearer and more accessible way. Regulations could also confer additional powers on HM Treasury or on a regulator and could authorise a regulator to make rules and charge fees.

Regulators would then be able to use their rule-making powers to replace revoked legislation with new rules following their normal rule-making process. However, HM Treasury could make regulations disapplying a regulator's obligations under FSMA to consult and carry out a cost-benefit analysis where the regulator is adopting rules that restate revoked legislation without material changes.

The Bill does not include a 'sunset' provision by which all EU-derived legislation on financial services and markets would be repealed and the government envisages that the process of revoking, replacing and revising that legislation would take a number of years. This is a much bigger task than onshoring under the EUWA, where the government's role was limited to modifying retained EU law to ensure that it worked effectively after Brexit.

The government would need to decide whether, after the end of the transitional period, EU-derived legislation is to be retained, in whole or in part and with or without modifications, whether it should be retained in the form of stand-alone regulations or via amendments to primary legislation (eg, as part of FSMA itself) or other subordinate legislation and the extent to which the replacement or modification of all or part of the revoked legislation should be delegated to regulators under existing or new powers or via the new designated activities regime (discussed below). The regulators would also need to decide on how to use their powers through their own rulemaking process to replace revoked legislation or to make new rules in areas that were previously constrained by EU-derived legislation. In the meantime, the government may use its powers to make regulations applying in the transitional period to make additional immediate changes to EU-derived legislation, eg, to implement the planned changes to Solvency II or the prospectus regime.

The process should result in a clearer, more accessible and more adaptable ruleset than exists today. More of the regulatory regime would be structured as PRA or FCA rules allowing the UK regulators greater discretion to amend or waive rules to implement policy changes or to address the individual circumstances of regulated firms. However, it seems likely that the European Commission would continue to rely on the prospect of future divergence between UK and EU law as a reason for not making any new equivalence decisions in relation to the UK even if the new powers are not used to make a 'bonfire of regulations' and do not result in any significant change to the regulatory outcomes delivered by the UK regime.

HM Treasury would have ongoing rule-making power across a wider range of policy areas than under FSMA (where its principal policy-making powers are limited to setting the perimeter of the authorisation requirements and the financial promotion regime). It would have ongoing powers to modify all revoked EU-derived legislation to the extent restated via HM Treasury regulations as well as the new rule-making powers under the designated activities regime and other provisions of the Bill discussed below. This should limit (although it would not eliminate) the need to rely on new primary legislation to implement future policy initiatives.

Revoking, replacing and revising EU-derived legislation will be a demanding process for government, regulators and market participants. There would need to be extensive consultation with stakeholders to ensure that the impact of restatements or modifications is fully understood. Market participants would need adequate time to implement any resulting changes in the requirements that apply to them, including changing documentation and client outreach.

How does the Bill relate to the proposed 'Brexit Freedoms Bill'?

The Queen's speech setting out the government's legislative agenda for this Parliamentary session stated that the government would also introduce a 'Brexit Freedoms Bill' to enable all retained EU law to be amended, repealed or replaced, to modernise the UK approach to making regulations and to remove the supremacy of retained EU law and clarify its status in the UK. The House of Commons European Scrutiny Committee has recommended that this Bill should include provisions that would go further than the Financial Services and Markets Bill, including provisions setting a 'sunset' date by which all retained EU law would be removed from the statute book, ending the residual supremacy of retained EU law over Acts of Parliament made before 1 January 2021 and providing that retained EU law would lose its special status as soon as it is amended in any way.

What is the new designated activities regime?

The Bill would create a new regime prohibiting anyone from carrying on 'designated activities' (unless exempted) or carrying on those activities otherwise than in accordance with designated activity regulations or FCA rules adopted in accordance with those regulations. HM Treasury would be able to make regulations designating activities for this purpose, providing for exemptions, specifying restrictions that apply to those activities and authorising FCA to make rules or give directions applying to persons carrying on those activities.

Activities may only be designated if they relate to UK financial markets or exchanges or financial instruments, financial products or financial investments that are to be issued or sold to, or by, persons in the UK. The requirements under the regime may apply both to authorised persons under FSMA and others, including persons outside the UK.

Initially the new regime may be used to replace EU-derived legislation being revoked under the Bill, eg, the retained EU law on short selling or the margining of OTC derivatives (instead of restating that legislation as part of FSMA or as new stand-alone regulations under the powers discussed above). However, it may also be used in other cases in future to regulate persons that are not authorised under FSMA.

What are the changes to the regulators' objectives and accountability mechanisms?

The Bill would change the regulators' objectives to include, as secondary objectives:

- for both the FCA and the PRA, to facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy (including in particular the financial services sector) and its medium to long term growth;
- for the PRA, to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities (the FCA is already subject to a similar objective for authorised persons generally); and
- for the Bank of England, to facilitate innovation in the clearing and settlement services provided by central counterparties (CCPs) and central securities depositories (CSDs) with a view to improving the quality, efficiency and economy of the services they provide.

In addition, the Bill would:

- ***regulatory principles:*** update the principles to which the regulators must have regard:
  - to include specific reference to the UK's commitment to achieve net zero by 2050;
  - to require the Bank of England to have regard to similar regulatory principles as the FCA and the PRA;
- ***recommendation letters:*** require the regulators to respond to HM Treasury's annual letters recommending how they should take into account matters of government economic policy;
- ***rule-making process:*** allow HM Treasury to:
  - direct the regulators to make rules in particular areas;
  - specify additional matters to which the regulators must have regard when making rules in particular areas;
- ***regulatory rule reviews:*** make specific provisions on rule reviews by:
  - requiring the regulators to keep their rules under review and to publish statements of policy on how they conduct these reviews;
  - allowing HM Treasury to direct the regulators to conduct a rule review or to appoint an independent reviewer;
- ***stakeholder panels:*** update the arrangements on stakeholder panels by:
  - placing the FCA's Listing Authority Advisory Panel and the insurance sub-committee of the PRA Practitioner Panel on a statutory footing;
  - requiring the regulators regularly to communicate on how they have engaged with their stakeholder panels and to publish statements of policy on their appointment of members of those panels;
- ***cost-benefit analysis (CBA):*** require the regulators to publish statements on their approach to CBA and to require the FCA and the PRA (with the Bank) to establish panels to support the development of their CBA;
- ***Parliamentary oversight:*** require the regulators to notify the relevant Parliamentary select committee when publishing a consultation and to respond in writing to formal responses to relevant consultations from Parliamentary committees (but the government does not otherwise propose changes to the current system of Parliamentary oversight and scrutiny);
- ***powers to grant permissions:*** permit HM Treasury to make regulations allowing FCA or PRA to give permissions disapplying or modifying their rules in individual cases (in addition to their existing general powers to modify and waive their rules, so as to permit the restatement of existing arrangements under retained EU law allowing the regulators to grant permissions in particular cases); and
- ***co-operation on wider implications:*** require the FCA, the Financial Ombudsman Service and the Financial Services Compensation Scheme to cooperate on issues with wider implications, to ensure that existing cooperation arrangements endure over time.

The government has stated that it is continuing to consider whether to add an additional 'call-in' power to the Bill during the legislative process which would allow HM Treasury to intervene in regulation in exceptional cases (compare, eg, the powers of the Secretary of State to call in M&A transactions for review under the National Security and Investment Act).

How does the Bill address the UK's international obligations?

The Bill would allow HM Treasury to make regulations implementing the UK's international agreements providing for the mutual recognition of the equivalence of the law and practices of the UK and other countries (such as the arrangements under discussion with Switzerland). Regulations could modify legislation and confer powers on HM Treasury and the regulators to give effect to the agreement.

In addition, the Bill would require the regulators, when making rules or general policies, to:

- consider decisions by HM Treasury on the equivalence of other country's laws or practices to UK law and practice and to consult HM Treasury if their actions might be inconsistent with such a decision and;
- notify HM Treasury if they are consulting on rules or policies that may be incompatible with the UK's commitments under free trade agreements or World Trade Organisation rules.

The Bill does not make any changes to the UK overseas persons regime.

What are the immediate changes to EU-derived legislation?

Implementing outcomes of the Wholesale Markets Review by:

- removing the share trading obligation (STO);
- replacing the pre-trade transparency waiver regime and removing the double-volume cap;
- changing the definition of systematic internaliser;
- removing restrictions on midpoint crossing for trades;
- aligning the derivatives trading obligation (DTO) with the EMIR clearing obligation;
- exempting post-trade risk reduction services from the DTO;
- giving the FCA a permanent power to modify or suspend the DTO (separately, the government is extending the existing temporary power to end-2024);
- simplifying the transparency regime for fixed income and derivatives;
- simplifying the position limits regime.

Creating a framework under which HM Treasury can designate other countries' frameworks as equivalent to the UK regime for simple, transparent and standardised securitisations for the purposes of investment by UK institutions.

What are the changes for financial market infrastructure (FMI)?

The Bill would change the way FMIs are regulated in the UK by:

- ***FMI Board:*** placing the Bank of England's decision-making FMI Board on a statutory basis as a new FMI Committee;
- ***rule-making powers:*** giving general rule-making powers to:
  - the Bank of England, in relation to CCPs and CSDs; and
  - the FCA, in relation to recognised investment exchanges (RIEs) and data reporting services providers (DRSPs), which would give the FCA (in the latter case) tools to facilitate the development of a consolidated tape;
- ***senior managers and certification regime (SM&CR):*** introducing an SM&CR which can be applied to CCPs and CSDs and allowing HM Treasury to apply the regime to RIEs and credit rating agencies;
- ***non-UK CCPs and CSDs:*** allowing:
  - the Bank of England to determine that a non-UK CCP is systemically important and to apply its domestic rule-book, in whole or in part, to such CCPs; and
  - HM Treasury to give the Bank further powers to apply domestic rules to non-systemic non-UK CCPs and CSDs in the future;
- ***FMI sandboxes:*** allowing HM Treasury to set up FMI sandboxes to enable firms to test and adopt new technologies and practices (such as distributed ledger technology) under temporary modifications to legislation; and
- ***CCP resolution:*** replacing the resolution regime that applies to CCPs to give the Bank of England additional powers, including powers to: require the removal of impediments to resolution; require the holding of additional resources as 'skin-in-the-game; restrict distributions on equity and variable remuneration; temporarily suspend termination rights; take control of a CCP; remove and replace directors; terminate contracts to achieve a matched book; haircut variation margin gains; bail-in unsecured liabilities and make cash calls on clearing members; and delay enforcement of a clearing member's obligations. It would also provide for a no-creditor worse off safeguard for creditors in relation to actions taken in resolution.

What are the other major changes?

The Bill makes a wide range of other changes, including the following:

- ***Critical third parties:*** HM Treasury would be able to designate cloud and other third-party service providers as 'critical' giving the Bank, PRA and FCA powers to directly oversee the services they provide to regulated firms and FMIs.
- ***Digital settlement assets:*** The Bill would:
  - give HM Treasury powers to establish an FCA authorisation and supervision regime for 'digital settlement assets' (broadly, crypto-assets used for the settlement of payment obligations);
  - enable HM Treasury to recognise operators of systemic payment systems and systemic service providers using digital settlement assets for regulation and supervision by the Bank of England;

  - enable the Payment Services Regulator (PSR) to regulate payment systems using digital settlement assets;
  - allow HM Treasury to extend the FMI special administration regime to firms recognised under this regime; and
  - allow HM Treasury to establish a mechanism to ensure that recognised firms are not subject to conflicting requirements under FCA or PRA rules.
- ***Access to cash:*** The Bill would allow HM Treasury to designate firms to be subject to FCA oversight for the purpose of ensuring the continued provision of cash access services (both for withdrawals and deposits) across the UK. The Bill would also give the Bank of England powers to oversee the wholesale cash industry, including powers to oversee and regulate the market activities of the industry and to prudentially regulate systemic entities in the market (should any emerge in the future).
- ***Cash ratio deposits:*** The Bill would replace the cash ratio deposit scheme under which banks currently fund the Bank of England's monetary policy and financial stability functions, with a new levy scheme.
- ***Insurers in financial difficulties:*** The Bill would:
  - make changes to the existing power of the court under FSMA to write down the unsecured liabilities of insolvent insurers, including clarifying its scope, creating a statutory moratorium during a write-down, providing for the appointment of a 'write-down manager' and providing for the rules of the Financial Services Compensation Scheme to require payments to policyholders whose claims are reduced by a write-down;
  - introduce a moratorium on suppliers and other contract counterparties to insurers exercising rights under contractual termination clauses during an administration, during a write-down process or while there is a pending winding-up petition; and
  - introduce a temporary moratorium on life insurance policyholder surrender and switching rights which would apply in the same circumstances as the moratorium on contractual termination rights.

  However, the Bill would not introduce a full recovery and resolution regime for insurers, which remains under review.

- ***Authorised push payment (APP) scams:*** The Bill would make clear that the PSR can use its regulatory powers (whether in relation to payment system operators, payment service providers, or in combination), to require mandatory reimbursement by payment service providers in cases of APP scams.
- **Financial promotions:** The Bill would require authorised firms to obtain a specific permission from the FCA to approve the financial promotions of unauthorised firms.
- ***Change in control:*** The Bill would broaden the range of circumstances in which the regulators can impose conditions on an approval for a change in control of an authorised firm.

What happens next?

The legislative process will get under way in September and the Bill may be amended during the process. However, absent an intervening general election, the Bill should be passed and become law by the end of this Parliamentary session (expected to be in May 2023). Following this, HM Treasury would be able to bring its provisions into force on days to be appointed (to the extent not specified in the Bill) and the government and regulators could begin the process of adopting and implementing the regulations and rules contemplated by the new law.

What should firms do now?

Regulators have already begun consultation on some of the changes that would be made by the Bill and enactment of the Bill will trigger an extensive programme of consultation on proposed changes. Firms will need to monitor these consultations as they are published or, if the decision is made not to consult on proposed rules, to monitor notifications that rules are being amended.

The impact of these changes will depend on the outcome of these consultations - but even where the intention is just to restate existing rules, the process of recasting EU legislation is likely to result in some changes. For example, the restated legislation may introduce new, more consistent terminology, link existing terms to differing rulebook definitions or simply change the way in which firms must refer to legislation in documentation. Also, as legislation is re-made, existing EU guidance and Q&A will cease to be relevant, and new regulations and rules will need to be assessed considering statements made in the consultation process or any new guidance from the UK regulators.

It is likely that these changes will result in the need to amend internal and external policies and procedures, as well as client-facing documentation. As these changes will be implemented over a period of months and years (rather than as a single 'big bang'), firms will need to consider how to communicate their impact to clients and how to ensure that all relevant employees are up to date on the latest developments.

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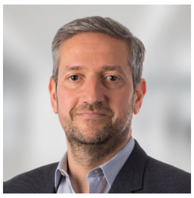

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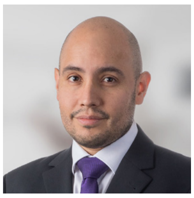

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