

Proposal for a temporary transitional power to be exercised by UK regulators

8 October 2018

1. Financial services legislation under the European Union (Withdrawal) Act

On 27 June, HM Treasury set out its approach to financial services legislation which would be introduced under the European Union (Withdrawal) Act 2018 (the “Act”) as part of preparations for the UK’s withdrawal from the EU. It remains the government’s objective and expectation that the UK will conclude a withdrawal agreement with the European Union (EU), which will provide for an implementation period that will be in place from 29 March 2019 until 31 December 2020. This implementation period will allow time for entities carrying on business in the financial services sector (“firms”) and consumers to adjust to the UK’s withdrawal from the EU.

Nevertheless, the Government has a duty to be prepared for any scenario, including the scenario in which no withdrawal agreement is concluded and there is no implementation period. As set out in HM Treasury’s policy document of 27 June, the Treasury will use powers in the Act to ensure that the UK has a fully functioning financial services regulatory regime in any scenario (this is referred to as “onshoring”). HM Treasury has begun to publish and lay before Parliament the statutory instruments (“SIs”) that will ensure the UK’s regulatory regime is ready.

2. Specific transitional measures to minimise disruption

The Act permits ministers to make transitional provision in connection with changes made under the Act to remedy the failure of, or deficiencies in, retained EU law. HM Treasury will be using legislation under the Act to introduce a range of transitional arrangements that will maximise continuity and minimise disruption to firms and consumers as we leave the EU, including in the no-deal scenario. For example, draft SIs have now been laid before Parliament which would introduce a Temporary Permissions Regime (“TPR”) and a Temporary Recognition Regime (“TRR”). The TPR will enable firms and funds currently passporting into the UK to continue their activities in the UK for a limited time after exit. The TRR will allow relevant non-UK Central Counterparties (“CCPs”) to continue their activities in the UK for a limited period after exit. These temporary regimes will allow sufficient time for those firms that wish to maintain their business in the UK to obtain UK authorisation. Using legislation under the Act, HMT intends to introduce additional transitional arrangements to address specific issues, as appropriate.

3. Proposal for a temporary transitional power for UK financial regulators

As set out in the policy document published on 27 June, HM Treasury’s approach to financial services legislation under the Act is to provide continuity. Wherever practicable, the same laws and rules that are currently in place in the UK should continue to apply after exit. However, some adjustments to those laws and rules will be required to reflect the UK’s new position outside of the EU. And in some cases, the adjustments will change firms’ regulatory obligations. These adjustments will take effect on 29 March 2019 if the UK leaves the EU without a withdrawal agreement and without an implementation period. In this scenario, HM Treasury recognises that it might be challenging for firms to make the changes necessary to comply with their changed regulatory obligations in this timeframe. Firms, including EEA firms that enter into one of the transitional regimes referred to above, may need more time to adjust to some of these changes.

HM Treasury and the UK regulators set out in June that they do not expect firms providing services within the UK’s regulatory remit to have to prepare now to implement these changes from 29 March 2019. HM Treasury will ensure that the UK’s regulatory regime is flexible enough to support

firms as they adjust to altered regulatory requirements in the unlikely event that there is no implementation period.

In addition to the specific transitional measures referred to above, HM Treasury therefore intends to temporarily empower the UK financial regulators – the Bank of England, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) - to make transitional provision by waiving or modifying firms' regulatory obligations where those obligations have changed as a result of onshoring financial services legislation. For example, the power could be used to delay the application of onshoring changes. The power will enable transitional provision to be made in response to changes to the regulators' own rules, onshored EU regulations (that will form part of retained EU law) and EU-derived domestic primary and secondary legislation. The power could be used to grant transitional relief in respect of any existing regulatory requirements that would otherwise apply for the first time on exit day to a particular category of firm, for example firms in the temporary regimes referred to above.

The temporary transitional power being proposed is necessary to ensure that UK regulators can continue to meet their statutory objectives in the unlikely scenario that the UK leaves the EU without an implementation period. In particular, it is essential that changes to firms' regulatory obligations do not pose a risk to the UK regulators' objectives that have been set by Parliament – these include financial stability, the safety and soundness of firms, policyholder protection, market integrity, and consumer protection. The regulators are best placed to identify where the changes to firms' regulatory obligations may present risk to their objectives. Therefore, the temporary transitional power will allow the UK regulators, in line with their regulatory remits, to identify and manage those risks so that firms transition to the UK's post exit regime in an orderly way, in line with the objectives already set by Parliament.

The ability of the PRA and FCA to adapt the application of certain regulatory requirements is already provided for in the UK's regulatory framework. Under section 138A of the Financial Services and Markets Act 2000 (FSMA), the PRA and the FCA may waive or modify the application of a rule made under FSMA where certain statutory criteria are met. HM Treasury proposes to adapt and extend this concept for the no-deal scenario by providing the UK regulators with a temporary power available to be used in respect of all firms, that could be applied beyond the regulators' own rules, for the specific purpose of enabling firms to adjust to onshoring changes in an orderly way (rather than the criteria in section 138A FSMA needing to be satisfied).

4. Design of the temporary transitional power

HM Treasury intends to use powers under the Act to delegate this temporary transitional power to the financial regulators. The power could be used where, in the judgment of the regulators, transitional provision would be appropriate to enable firms to adjust to the post-exit regulatory framework in an orderly way. Transitional provision could include, for example, delaying onshoring changes so that firms could comply with pre-exit standards for a limited time after exit, rather than needing to implement the relevant onshoring changes by 29 March 2019. Transitional relief could not be granted if this would undermine the regulators' statutory objectives. The power could not be used for any purpose other than facilitating firms in adjusting to the UK's post exit regulatory regime. As such, it could not be used to waive or modify a firm's pre-exit obligations where they are unaltered by legislation made under the Act.

The power to make transitional provision would be available to the regulators for 2 years from exit. Transitional provision made using the power would cease to have effect after 2 years from exit.

The power could be used to grant transitional relief in relation to changes under the Act which have been made to regulatory requirements where UK regulators are responsible for supervising compliance, including regulatory requirements which form part of:

- i. PRA and FCA rules made under FSMA
- ii. Onshored Binding Technical Standards (BTS)
- iii. Onshored EU financial services regulations or delegated regulations
- iv. Relevant UK primary or secondary legislation

Transitional relief could be granted to particular firms, classes of firms, or all firms to which a particular onshoring change applies, including firms that have entered into one of the transitional regimes referred to above. Firms would not need to apply for transitional relief in order to benefit from it. Rather, the regulators will issue “directions” that set out the terms of the proposed transitional relief. The directions would normally be published on the regulators’ websites, except where this was inappropriate or unnecessary.

But, as set out above, the proposed transitional power could only be used for the limited purpose of facilitating firms in adjusting to the UK’s post exit regulatory regime – it is not a general power to waive or modify these requirements for any other reason. Where specific transitional provision in relation to a particular issue has already been made in a HM Treasury statutory instrument made under the Act, the power would not need to be used, as no additional transitional relief would need to be provided for. The power would also not be available to alter the following requirements:

- i. Any provision that sets the ‘regulatory perimeter’ for UK financial services activity
- ii. FSMA threshold conditions
- iii. Any provision or requirement which is not within the regulatory remit of the UK financial services regulators

HM Treasury proposes to confer this power on the Bank of England, the PRA and the FCA in an affirmative procedure statutory instrument under the Act. The instrument will be laid before Parliament in due course.