**DRAFT STATUTORY INSTRUMENT TO ILLUSTRATE THE USE OF THE CLAUSE 7 POWER UNDER THE EUROPEAN UNION (WITHDRAWAL) BILL**

**Covering note on the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018**

**Context and Overview**

The European Union (Withdrawal) Bill ("the Bill", or EUWB) will repeal the European Communities Act 1972 on the day the United Kingdom leaves the European Union (EU). The purpose of the Bill is to provide a functioning statute book on the day we leave the EU.

The Bill will create powers to make secondary legislation, including temporary powers, to enable corrections to be made to laws that would otherwise no longer operate appropriately once the UK has left the EU.

The *Memorandum concerning the Delegated Powers in the Bill*[1] provided some examples of how the powers in the Bill could be used to make secondary legislation, and stated that more sample drafting will become available during the Bill's passage.

This sample SI should be taken as an illustrative example of how the powers in the Bill may be used, and not as the final draft for consultation.

**Detail**

1 The attached draft statutory instrument from HM Treasury is to help inform Parliamentary scrutiny of the EUWB, and to provide Parliament with as much detail as possible on HM Treasury's proposal to allocate responsibility for 'onshored' EU financial services regulation to UK authorities. The draft instrument is still in development. The drafting approach, and other technical aspects of the proposal, may need to change before the final instrument is laid before Parliament. In particular, the allocation of Binding Technical Standards (BTS) to the different parts of the Schedule to the instrument is still under consideration.

2 HM Treasury plans to lay this instrument before Parliament using the affirmative procedure as soon as possible after the EUWB has received Royal Assent. Early making of this instrument will maximise the time that UK regulators will have available to correct deficiencies in onshored BTS and domestic regulator rules, in order to provide industry with clarity on these changes ahead of the UK's withdrawal from the EU.

**HM Treasury's proposed approach to the allocation of responsibility for 'onshored' EU financial services regulation**

3 The EUWB will incorporate directly applicable EU law into UK law, and save relevant domestic legislation relating to EU membership, as we leave the EU. The

[1] https://publications.parliament.uk/pa/bills/cbill/2017-

Bill will also provide a power to Ministers to make statutory instruments to 'fix deficiencies' that arise in that law as a result of the UK's withdrawal from the EU. For financial services, a significant part of the regulatory and supervisory framework is derived from EU law. HM Treasury's proposal seeks to ensure that the post-exit financial services regime reflects the UK's existing domestic regulatory framework, as previously approved by Parliament in successive pieces of legislation.

4 HM Treasury proposes to follow the model used by the Financial Services and Markets Act 2000 (FSMA), the key piece of framework legislation for regulation of financial services in the UK. FSMA establishes the objectives, functions and responsibilities of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). FSMA then delegates responsibility to these regulators for making the detailed rules that apply to firms in order to operationalise the framework which Parliament has set in legislation.

5 Following this model will mean that EU 'Level 1' legislation (which was developed by the European Commission and negotiated through the Council and European Parliament) and 'Level 2' legislation (apart from BTS and certain other technical elements of Level 2), will become the responsibility of the UK Parliament. This body of EU legislation includes provisions which set the policy direction for financial services, so it is appropriate that responsibility for deciding how deficiencies are fixed in this legislation should rest with Parliament. HM Treasury will propose amendments to this legislation, using the powers under the EUWB, ensuring that Parliament is able to scrutinise all of the changes. It is expected that the majority of the statutory instruments needed to correct deficiencies in this legislation will be laid under the affirmative procedure.

6 For certain EU 'Level 2' technical rules, known as Binding Technical Standards (BTS), HM Treasury proposes to transfer ongoing responsibility from the European Supervisory Authorities to the UK financial regulators – the Bank of England, the PRA, the FCA and the Payment Systems Regulator (PSR). BTS, running to several thousand pages, do not set overall policy direction but fill out the technical detail of how the requirements set at Level 1 are to be met. Having played an important role in the EU to develop these standards, through their membership of the Boards and working groups of the European Supervisory Authorities, UK regulators have the necessary expertise and resource to maintain them after the UK's exit from the EU. This allocation of responsibility would be consistent with the general rule-making responsibilities already delegated to the FCA and PRA by Parliament under FSMA.

7 As HM Treasury proposes to transfer ongoing responsibility for BTS to the UK regulators, it also makes sense that the regulators perform the task of making corrections to deficiencies in existing BTS so that these rules operate effectively in the UK at exit. HM Treasury therefore proposes to delegate to UK financial regulators the power to correct deficiencies in BTS arising from EU withdrawal.

8 In addition, HM Treasury proposes to delegate the EUWB deficiency-fixing power to UK financial regulators so as to allow them to correct deficiencies in existing regulator rules (or FSMA rules) that arise as a result of the UK's withdrawal from the EU. Under the existing FSMA framework, the PRA and FCA already have

powers to amend these rules. However, the procedures to use these powers were not designed to deliver the volume of rule amendments that will be needed as a result of leaving the EU and these procedures may not always be appropriate for the task. Delegating the EUWB deficiency-fixing power in this way will give UK regulators the flexibility to ensure that the full set of EU-derived rules for which they are responsible will operate effectively after exit.

9 As well as the proposed approach to transferring responsibility for BTS, HM Treasury proposes to use affirmative procedure statutory instruments under the EUWB to transfer various supervisory functions, currently performed by the EU Supervisory Authorities, to UK regulators. For example, the Bank of England would take on the function currently performed by the European Securities and Markets Authority (ESMA) of "recognising" non-UK Central Counterparties (CCPs) so that they can provide services in the UK.

10 HM Treasury believes that the approach outlined here is an appropriate allocation of responsibilities which respects the existing regulatory framework set by Parliament, ensures democratic accountability for framework legislation which sets the direction of policy, and fits with the existing responsibilities of UK financial regulators.

**Correcting deficiencies in EU Binding Technical Standards and FSMA rules – Part 2 of the draft statutory instrument**

11 Part 2 of the draft statutory instrument would delegate the EUWB power for fixing deficiencies in BTS and FSMA rules to the Bank of England, the PRA, the FCA and the PSR. It applies analogous requirements and constraints that would apply to HM Treasury's exercise of that power (including the 2-year time limit on the power) to the fixing of deficiencies by the specified regulators. Therefore, under this delegated power, the regulators would only be able to make changes to correct deficiencies that arise as a result of the UK's withdrawal from the EU.

12 As well as specifying the UK regulators that will be able to correct deficiencies in BTS and FSMA rules, Part 2 and the Schedule to the statutory instrument will specify the appropriate regulator for each BTS. The Schedule will provide a list of BTS and the EU directives or regulations under which they were made. The draft Schedule is not final and has been provided here for illustrative purposes only.

13 The instruments that the regulators will use to correct deficiencies in BTS and FSMA rules will be called "EU Exit Instruments". This statutory instrument will be used to seek Parliament's approval for the regulators to make these instruments without laying them before Parliament. HM Treasury believes this is appropriate as the required corrections for BTS and FSMA rules will be of a highly technical nature and will, in any case, be aligned with the changes that Parliament will be asked to approve in onshored Level 1 legislation.

14 Part 2 sets out the procedure with which the regulators must comply when making an EU Exit Instrument. This includes:

a. HM Treasury must approve every EU Exit Instrument and may only approve an instrument if it considers that the instrument makes appropriate provision to fix deficiencies arising from the UK's withdrawal from the EU, in accordance with the provisions of the EUWB;

b. HM Treasury must be provided with a copy of an EU Exit Instrument once it has been made; and
c. The EU Exit Instrument must be published by the appropriate regulator in the way best calculated to bring the instrument to the attention of the public.

15 A limited number of BTS will be relevant to financial services firms or activities that are the responsibility of more than one UK regulator. These BTS, which will have more than one appropriate regulator, are identified in the Schedule. The statutory instrument provides a power for the regulators to introduce an EU Exit Instrument to modify these BTS so as to make separate provision for the purposes of the different regulators' remits. When a BTS is modified in this way, the appropriate regulators can make separate amendments, obtaining consent from the other on the respective changes, or the BTS can be divided into two parts, with the first part making provision for FCA remit and the second part making provision for either PRA regulated firms or for activities that are the responsibility of the Bank of England. Where a regulator proposes to make separate BTS provision using the second procedure, it must consult the other appropriate regulator.

**UK regulators' exercise of their responsibility for BTS after exit – Part 3 of the draft statutory instrument**

16 Part 3 of the draft statutory instrument sets out the basis on which UK regulators are to exercise their on-going functions in relation to BTS, including the procedure for making "standards instruments" which will be used to make BTS in the future.
Responsibility for making and amending BTS will be transferred to the appropriate UK regulator by 'onshoring' and amending each mandate for BTS that currently exists in EU law. For example, responsibility for developing BTS on the form and content of the financial reports that firms must submit to supervisors under the Capital Requirements Regulation is currently delegated to the European Banking Authority (EBA), with the European Commission responsible for bringing the final BTS into law. A statutory instrument made under the EUWB will amend this so that the responsibility for the specified BTS is transferred to the PRA and FCA.

17 By incorporating into UK law all of the specific legislative mandates for making BTS, UK regulators' responsibility for BTS will be limited to the purposes set out in those mandates. Parliament will be asked to approve the transfer of each mandate for BTS via the affirmative procedure, so that UK regulators would only take on responsibility for BTS once this has been approved by Parliament.

18 When making a standards instrument in order to amend a BTS, the appropriate regulator must comply with the following procedure:

a. A standards instrument must be submitted to HM Treasury for approval;
b. The instrument must specify the provision under which the instrument is being made – this will be one of the specific mandates to make BTS that will have been approved by Parliament, as explained above;

c. HM Treasury will have four weeks from submission of a standards instrument to decide whether the instrument is approved or not. If after four weeks from submission HM Treasury has not given notice that the instrument is approved or not approved, the instrument will be deemed approved by HM Treasury;
d. If HM Treasury decides not to approve a standards instrument, HM Treasury must notify the appropriate regulator in writing setting out the reasons for not approving the instrument;
e. A copy of the Treasury notice referred to above, along with an explanation from the appropriate regulator as to why the standards instrument was proposed, will be laid before each House of Parliament;
f. If approved by HM Treasury, the instrument must be published by the regulator in the way best calculated to bring it to the attention of the public; and
g. HM Treasury must lay before Parliament a copy of each standards instrument.

19 As set out above, the instrument can only be made if it has been approved by HM Treasury. HM Treasury may only refuse to approve a standards instrument if it appears to HM Treasury that the instrument would have implications for public funds, or would prejudice negotiations for an international agreement. This role for HM Treasury to approve proposed amendments to BTS is not intended to supplant consideration of the UK regulators' statutory objectives, but to complement them. It is appropriate that the Treasury is able to ask a regulator to think again about any proposed change to BTS which would have consequences for public funds (as defined in the Banking Act 2009), or could affect negotiations for an international agreement (for example, negotiations for a trade agreement) in a way that HM Treasury believes would not serve the interests of the UK. FSMA already allows HM Treasury to direct UK regulators to take action that is necessary for the UK to comply with its existing international obligations.

20 Consistent with the approach of aligning the regulators' new function for BTS with the existing PRA and FCA responsibility for FSMA rules, the statutory instrument will make onshored BTS subject to analogous requirements in FSMA that currently apply to the making of FSMA rules. For example, the BTS standards making power will be subject to the statutory objectives which Parliament has given to the regulators, and there will be requirements for the regulators to consult on any proposal to make changes to BTS.

21 The vast majority of BTS will become the responsibility of the Bank of England, the PRA and the FCA. There is are also one BTS relating to the EU Interchange Fee Regulation which will need to be transferred to the UK's Payment Systems Regulator (the PSR). The statutory basis for the PSR is the Financial Services (Banking Reform) Act 2013, which will be amended by this statutory instrument as part of conferring the new standard-making power on the PSR. As much as possible, this new power will follow the model used in FSMA for the PRA and FCA's rule-making responsibilities.

**Excluding the use of the regulators' general rule-making powers to amend retained direct EU legislation**

22 Schedule 8, paragraph 3 of the EUWB provides that where there are existing powers to make subordinate legislation (such as the regulators' existing powers to make FSMA rules), such powers may in certain instances be used for the purpose of amending retained direct EU legislation. However, as set out above, HM Treasury believes that it would not be appropriate for the regulators to amend on-shored Level 1 and non-BTS Level 2 legislation (which both fall within the definition of retained direct EU legislation) without Parliament debating and approving this explicitly. Part 3 of the statutory instrument therefore amends FSMA so that the regulators may not use their general rule-making power to amend retained direct EU legislation, except where this has been specifically authorised by Parliament.

23 It should be noted that amendments to the EUWB tabled by the Government would change the operation of schedule 8, paragraph 3 and HM Treasury may therefore need to revise the drafting approach for this statutory instrument. HM Treasury will want to ensure that the FSMA rule-making powers cannot be used to amend retained direct EU legislation without approval from Parliament.