



Financial Services and Markets Bill

Big Bang 2.0, or more of the same?

July 2022

On 20 July 2022, just before the UK Parliament's summer recess, the long awaited Financial Services and Markets Bill (FSM Bill) was introduced to Parliament.

The FSM Bill repeals hundreds of pieces of onshored EU financial services legislation in an attempt to create an 'open, green, and technologically advanced financial services sector that is globally competitive'. However, is the FSM Bill really the 'Big Bang 2.0' that the politicians are touting?

Over the coming weeks, we will be discussing the different proposals contained in the FSM Bill in more detail. As an introduction, this bulletin provides an overview of the FSM Bill's key proposals, and how (and when) they will affect market participants.

Is this Big Bang 2.0?

According to the UK government, the FSM Bill 'seizes the opportunities of EU Exit, tailoring financial services regulation to UK markets to bolster the competitiveness of the UK as a global financial centre and deliver better outcomes for consumers and businesses'. In reality, the picture is one of evolution rather than revolution. The FSM Bill lays the institutional and procedural foundations for divergence from the EU acquis, and makes limited policy changes to diverge from EU law in wholesale markets, insurance and securitisation regulation, but the real work – of picking through tens of thousands of pages of EU legislation, determining what policy changes to make to it, and making UK rules to replace the acquis – has just begun. 'Big Bang 2.0' will likely be a multi-year and incremental process.

Away from Brexit – other changes

Outside the post-Brexit agenda, the FSM Bill also makes a number of other changes which reflect ongoing international developments (central counterparties (**CCP**) recovery and resolution, stablecoin regulation, critical outsourcing), and deals with some gaps in the existing UK regulatory framework (eg around approval of financial promotions and authorised push payment (APP) fraud).

As is common with financial services legislation, the result for firms will be a mixed bag of changes which will affect different firms in different ways, come into effect over a reasonably long period and require a change management programme to identify and implement relevant changes. What is likely to be different this time is the sheer scale of technical change derived from the post-Brexit process. We simply do not know at this stage how far, and how fast, the authorities will seek to have the UK regulatory system diverge from Europe: but – whatever the intended outcome in divergence terms – the result will necessarily involve the creation of thousands of pages of regulatory rules replacing the *acquis*. So there will be a lot to do regardless. Transparency and openness from the authorities, and industry engagement, will be key to a successful outcome.

The FSM Bill's key proposals include:

Future regulatory framework – preparing the way for future divergence

A number of aspects of the FSM Bill redraw the UK regulatory structure to prepare the way for the future regulatory framework:

Replacing EU Law – The FSM Bill will establish a framework to revoke retained EU law relating to financial services, and will enable HM Treasury and the UK financial services regulators to replace it with legislation and, more commonly, regulatory rule sets designed specifically for the UK, to deliver a comprehensive FSMA model of regulation.

New Regulatory Powers Beyond Authorised Firms – The FSM Bill will create the Designated Activities Regime (**DAR**) to allow activities related to financial markets to be regulated within a framework that is compatible with a comprehensive FSMA model. The establishment of the DAR is intended to address the status of the regulation of certain activities, products or conduct that are regulated by retained EU law but that are not FSMA regulated activities. These activities apply to a broader range of entities than FSMA authorised persons and as a consequence, the existing UK Financial Conduct Authority (**FCA**) and Prudential Regulation Authority (**PRA**) rule-making powers for authorised persons do not currently apply to these activities.

Regulatory Frameworks for Financial Market Infrastructures (FMIs) – The FSM Bill will make revisions to the regulatory frameworks that apply to FMIs. It introduces a general rule-making power for the Bank of England (**BoE**) relating to CCPs and central securities depositories (**CSDs**), so that it can take on primary responsibility for setting regulatory requirements for these entities, establishes a legislative framework for 'systemic third country CCPs', and gives the FCA a general rule-making power relating to data reporting services providers (**DRSPs**) and recognised investment exchanges (**RIEs**) to enable it to replace the provisions in retained EU law relating to the regulation of DRSPs and RIEs and to ensure that the FCA has an effective way of upholding and enhancing standards in the future.

Mutual Recognition – The FSM Bill provides for HM Treasury to make changes to domestic legislation necessary to ensure that mutual recognition agreements (**MRAs**) related to financial services can be fully implemented, using secondary legislation. This includes the ability to grant any additional powers to the UK financial services regulators that are required to give effect to MRAs.

Accountability of Regulators, New Secondary Objective and Regulatory Principle – The FSM Bill includes new measures to increase the UK regulators’ accountability and relationships with government and stakeholders. These include the addition of a secondary competitiveness and growth objective for the FCA and the PRA, and the addition of a new regulatory principle for both the FCA and PRA relating to achieving the UK’s net zero emissions target, which could have a material impact on future regulation of capital and assets.

Divergence now – changes to the onshored EU acquis

The FSM Bill contains limited changes to diverge from the onshored EU acquis as a result of the Wholesale Markets Review and Solvency II review and makes limited changes to the securitisation regulatory framework:

Wholesale Markets Review – The FSM Bill takes forward the outcomes of the Wholesale Markets Review, with the aim of removing restrictions on trading in wholesale markets and to promote investments. The FSM Bill will make amendments to UK MiFIR, including: (i) replacing the pre-trade transparency waiver regime; (ii) stripping away the double volume cap; (iii) removing the share trading obligation; (iv) aligning the derivatives trading obligation (**DTO**) with the clearing obligation under UK EMIR; (v) exempting post-trade risk reduction services from the DTO; (vi) giving the FCA a permanent power to modify or suspend the DTO; (vii) simplifying the transparency regime for fixed income and derivatives; (viii) simplifying the position limits regime; (ix) changing the definition of a systematic internaliser; and (x) removing restrictions on midpoint crossing for trades.

Solvency II – By revoking the existing EU legislation, the FSM Bill includes provisions that will enable the UK to diverge from EU Solvency II as foreshadowed in the Solvency II review. The FSM Bill also implements the new regime for insurers in financial difficulty (including provisions for the writing down of insurers’ liabilities and restrictions on the exercise of contractual rights in certain circumstances).

Securitisation – The FSM Bill will make amendments to the UK Securitisation Regulation to establish a framework under which HM Treasury can designate other jurisdictions as having a simple, transparent and standardised (**STS**) securitisation framework equivalent to that of the UK. This will allow for STS equivalent non-UK securitisations to be recognised in the UK, with appropriate safeguards, provided they are originated in a jurisdiction that has an equivalent framework for STS securitisations to the UK.

International developments

Reflecting emerging international consensus, the FSM Bill brings stablecoins into the scope of regulation, introduces a recovery and resolution framework for CCPs, and empowers regulation of critical service providers to the regulated sector:

Digital Settlement Assets – The FSM Bill brings activities facilitating the use of certain stablecoins, where used as a means of payment, into the UK regulatory perimeter, primarily by amending the existing electronic money and payment system regulatory frameworks. It introduces a definition of ‘digital settlement assets’ (**DSAs**), a new concept which has not been previously defined in legislation ‘*a digital representation of value or rights, whether or not cryptographically secured, that (a) can be used for the settlement of payment obligations; (b) can be transferred, stored or traded electronically; and (c) uses technology supporting the recording or storage of data (which may include distributed ledger technology)*’.

CCPs in Financial Difficulty – The FSM Bill contains provisions for a revised special resolution regime for CCPs where all or part of the business has encountered or is likely to encounter financial difficulties. It will also delete provisions in the Banking Act 2009 relating to the existing special resolution regime for CCPs.

Critical Third Parties – The FSM Bill will enable HM Treasury to designate certain third party service providers to regulated firms as ‘critical’ and will give the BoE, PRA, and FCA the ability to directly oversee critical services provided to regulated firms and FMIs by designated critical third parties. This will allow the UK regulators to intervene to raise the resilience of these services and reduce the risk of systemic disruption in the finance sector.

Other changes

Senior Managers and Certification Regime (SMCR) for FMIs – The FSM Bill introduces a SMCR for CCPs and CSDs that is similar to the existing SMCR for banks, insurers and other authorised persons. It will also give HM Treasury the power to apply the regime to credit rating agencies and RIEs.

Regulatory Gateway for Approving Financial Promotions – The FSM Bill amends section 21 of the Financial Services and Markets Act 2000 (**FSMA**) to establish a new regulatory ‘gateway’ which authorised firms must pass through before being able to approve the financial promotions of unauthorised firms. Any authorised firm wishing to approve the financial promotions of unauthorised firms will first need to obtain the permission of the FCA. The FCA will also be able to place limitations on the types of promotions firms will be able to approve, for example, restricting firms to approving financial promotions in their field of expertise.

Access to Cash – The use of cash is declining in the UK. This has led to the closure of bank and building society branches and the closure of some free-to-use ATMs. However, a significant proportion of the UK population still relies on cash. The FSM Bill contains provisions to ensure continued access to cash across the UK. The FCA will be the lead regulator for access to cash, and HM Treasury will be empowered to designate firms to be subject to FCA oversight for the purpose of ensuring the continued provision of cash access.

(APP) Scams – The FSM Bill contains provisions intended to provide greater support for victims of APP scams, enabling the Payment Systems Regulator to use its regulatory powers to require mandatory reimbursement by payment service providers in cases of APP scams.

Next steps

Before the FSM Bill can receive Royal Assent, it will have two more readings in the House of Commons, go through the Committee and Report stages, and then repeat the same process in the House of Lords. The second reading in the House of Commons is scheduled to take place on 7 September 2022, after the UK Parliament returns from its summer break.

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