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Brexit Statutory Instruments – a series of briefings

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Financial Regulators' Powers (Technical Standards) (Amendment etc) (EU Exit) Regulations 2018

This paper is part of a series of briefings for clients and contacts of Allen & Overy on the review of financial services statutory instruments (**SIs**) to be laid down under the European Union (Withdrawal) Act 2018 (the **Withdrawal Act**).

Introduction

The purpose of the SIs is to help with a range of legal issues caused by the UK's exit from the EU. One of the main issues is deficiencies in retained EU law that may occur from the UK's exit.

While devising the regime for financial services post-Brexit, HM Treasury confirmed its intention to follow the model used by the Financial Services and Markets Act 2000 (**FSMA**) which means that EU Level 1 and Level 2 requirements (primary and delegated legislation, excluding Binding Technical Standards (**BTS)**[1] and certain other technical elements of Level 2 that were implemented through the use of rules made under FSMA) will become the responsibility of Parliament. Recognising the role UK regulators played in drafting these at the European level, on-going responsibility for the BTS will be transferred to the Bank of England (**BoE**), the Prudential Regulation Authority (**PRA**), the Financial Conduct Authority (**FCA**) and the Payment Systems Regulator (**PSR**) as set out in the Schedule to the Financial Regulators' Powers (Technical Standards) (Amendment etc) (EU Exit) Regulations 2018 (the **Financial Regulators' Powers SI**).

The regulators will perform the task of making corrections to deficiencies in existing BTS so that the rules operate effectively post Brexit and HM Treasury has also proposed to delegate the Withdrawal Act deficiency-fixing powers referenced above to the 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. While FSMA already grants this power, that Act did not envisage the volume of amendments that will be required to take place for Brexit.

The FCA and PRA have informally indicated that they intend to adopt existing BTS at the point of Brexit so as to cause minimal disruption to firms.

What does the Financial Regulators' Powers SI do?

On 18 April 2018, HM Treasury published a draft of the Financial Regulators' Powers SI together with a covering note. When the Withdrawal Act was making its way through the Parliamentary process, HM Treasury (and other government departments) published a number of "illustrative" draft SIs to help inform Parliamentary scrutiny of the powers under the proposed Act. The purpose of publishing this SI was 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.

[1] BTS (regulatory technical standards or implementing technical standards) do not set overall policy direction, they are legal acts which specify particular aspects of an EU legislative text (Directive or Regulation) and aim at ensuring consistent harmonisation in specific areas. The relevant European Supervisory Authority develops the draft BTS which are finally endorsed and adopted by the European Commission (either in the form of a Regulation or Decision). Contrary to other documents such as Guidelines or Recommendations, the BTS are legally binding and directly applicable in all Member States. These are listed in the schedule to the Financial Regulators' powers SI.

On 16 July 2018, a revised version of the Financial Regulators' Powers SI was laid with a supporting explanatory memorandum.

EU Exit Instruments

The instruments that the regulators will use to correct deficiencies in BTS and rules made under FSMA will be called "EU Exit Instruments". The Financial Regulators' Powers SI ensures that regulators can make these instruments without laying them before Parliament. HM Treasury believed this was appropriate as the required corrections for BTS and FSMA rules will be of a highly technical nature. Part 2 of the SI sets out the procedure with which the regulators must comply when making an EU Exit Instrument.

An EU exit instrument may only be made if it has been approved by HM Treasury. Such approval will only be forthcoming if HM Treasury considers that the instrument makes appropriate provision to prevent, remedy or mitigate failures or deficiencies in retained EU law.

Standards instruments

Part 3 of the Financial Regulators' Powers SI 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 effectively be transferred to the appropriate UK regulator by 'onshoring' and amending each mandate for BTS that currently exists in EU law. When making a standards instrument in order to amend a BTS, the appropriate regulator will have to comply with a prescribed procedure.

HM Treasury is required to approve the instruments that the UK regulators use to make or amend BTS after Brexit. The approval function would only be used to refuse to approve a proposed change to a BTS if it appeared to HM Treasury that a proposed technical standard would have implications for public funds, or would prejudice any negotiations for an international agreement.

Amending retained direct EU legislation

Schedule 8, paragraph 3 of the Withdrawal Act 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. HM Treasury was of the view that it would not be appropriate for the regulators to amend on-shored Level 1 and non-BTS L2 legislation without Parliament debating and approving this explicitly. Part 3 of the draft SI 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.

Where the powers lie

The Schedule to the SI sets out which regulator is the appropriate regulator for specific EU legislation:

EU legislation for which the FCA is the appropriate regulator

Part 1 of the Schedule sets out the EU legislation for which the FCA is the appropriate regulator. This includes certain Commission Delegated Regulations made under the:

- Alternative Investment Funds Managers Directive
- Credit Rating Agencies Regulation
- European Markets Infrastructure Regulation
- European Social Entrepreneurship Fund Regulation
- European Venture Capital Funds Regulation
- Market Abuse Regulation
- Insurance Distribution Directive
- Markets in Financial Instruments Directive (recast)
- Markets in Financial Instruments Regulation

- Mortgage Credit Directive
- Packaged Retail and Insurance-Based Investment Products Regulation
- Payment Services Directive (recast)
- Prospectus Directive
- Short Selling Regulation
- Transparency Directive
- UCITS Directive.

EU legislation for which the PRA is the appropriate regulator

Part 2 of the Schedule sets out the EU legislation for which the PRA is the appropriate regulator. This includes certain Commission Delegated Regulations made under the:

- Capital Requirements Directive IV
- Capital Requirements Regulation
- Central Securities Depositories Regulation
- Institutions for Occupational Pension Provision Directive
- Solvency II Directive.

EU legislation for which the BoE is the appropriate regulator

Part 3 of the Schedule sets out the EU legislation for which the Bank of England is the appropriate regulator. This includes certain Commission Delegated Regulations made under the:

- Bank Recovery and Resolution Directive
- Central Securities Depositories Regulation
- European Markets Infrastructure Regulation

EU legislation for which both the PRA and FCA are the appropriate regulators

Part 4 of the Schedule sets out the EU legislation for which both the PRA and FCA are the appropriate regulators. This includes certain Commission Delegated Regulations made under the:

- Bank Recovery and Resolution Directive
- Capital Requirements Directive IV
- Capital Requirements Regulation
- European Markets Infrastructure Regulation
- Financial Conglomerates Directive
- Markets in Financial Instruments Directive (recast)

EU legislation for which both the BoE and FCA are the appropriate regulators

Part 5 of the Schedule sets out the EU legislation for which both the Bank of England and FCA are the appropriate regulators. This includes certain Commission Delegated Regulations made under the:

- Markets in Financial Instruments Regulation
- European Markets Infrastructure Regulation

EU legislation for which the PSR is the appropriate regulators

Part 6 of the Schedule covers a certain Commission Delegated Regulation under the Interchange Fee Regulation for which the PSR will be responsible

Points of interest in relation to the Financial Regulators' Powers SI – 'inflight' legislation

The Withdrawal Act ensures that direct EU legislation (ie legislation that currently applies in the UK automatically, without the need for UK implementing legislation) will form part of UK law on Brexit if it is 'operative immediately'

before exit day – that is, it is in force and applies immediately before exit day. It does not cover inflight legislation – ie legislation that is in force on exit day but not yet in application. While this distinction will be important in a number of areas, a key one for the financial services industry will be in relation to the new prospectus regime that came into force on 20 July last year. While a couple of provisions applied from that date and a couple more will apply from 21 July this year, the bulk of the regime will not apply until July 2019.

As a result, on a 'hard' Brexit, the Prospectus Regulation (Regulation (EU) 2017/1129) will only apply in the UK if provided for in further legislation. The Schedule to the Financial Regulators' Powers SI therefore refers to Commission Delegated Regulations made under Prospectus Directive 2003/71/EU and does refer to the new Prospectus Regulation.

What does this mean for you?

As this SI is an empowering SI, it does not affect the substantive rights and obligations of market participants. As and when the regulators issue BTS, firms will need to understand what (if any) changes may be made which affect their obligations.

Next steps

The UK Government is intending to lay all financial services related SIs prior to the end of 2018 as they form the basis of ensuring there is a functioning statute book if the UK leaves the EU on 29 March 2019 without the withdrawal agreement and proposed transitional arrangements having been ratified. This Financial Regulators' Powers SI would come into force on the day after the day on which it was made.

To the extent the withdrawal agreement is ratified, this SI and the other financial services SIs made under the Withdrawal Act will be withdrawn from the statute book with the form and structure of subsequent secondary legislation only emerging once a future trade relationship is agreed between the UK and EU 27.

Your Allen & Overy contacts

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