Dear Mr Hainsworth,

Financial Services (Implementation of Legislation) Bill

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

In June 2016, the U.K. voted to withdraw from the European Union ("Brexit") and on 29 March 2017 HM Government officially notified the E.U. of this decision, beginning a two-year "notice" and negotiation period, and setting the date on which the U.K. will withdraw from the E.U. ("exit day") as 29 March 2019. As the form of the longer-term post-Brexit relationship is, as yet, undecided, legislative preparations in the U.K. have focused on readying regulators and market participants alike for a "no deal" eventuality. A key component of these preparations is the European Union (Withdrawal) Act 2018 (the "Withdrawal Act") which, inter alia, makes provisions to retain in U.K. law all those pieces of E.U. regulation, E.U. decision or E.U. tertiary legislation which are "operative immediately before exit day". Subsection 3(3) of the Withdrawal Act clarifies that any direct E.U. legislation will be considered to be operative immediately before exit day if

a) in the case of anything which comes into force at a particular time and is stated to apply from a later time, it is in force and applies immediately before exit day,

The FMLC has in the past drawn attention to the operational uncertainties arising from this definition of "operative" in the Withdrawal Act and the consequence that E.U. legislation—where it comes into application section by section, staggered over time—will be converted into domestic legislation only in so far as the instrument has entered into force and applies before exit day. Where the date of application of a provision falls after exit day, the provision will not be converted into domestic law.

The FMLC understands that it is this complexity which HM Treasury wishes to address by means of the Financial Services (Implementation of Legislation) Bill (the "Bill" which was introduced in the House of Lords on 22 November 2018). The Bill provides the power to HM Treasury, in a no deal situation, to implement and make changes to a category of legislation which the Bill describes as "in-flight". Paragraph 1 of the explanatory notes to the Bill explain that "in-flight" files are pieces of E.U. financial services legislation that: (1) have been adopted by the E.U., but do not yet apply so cannot be captured by the Withdrawal Act (an exhaustive list is provided in Clause 1 of the Bill); or (2) are currently in negotiation and may be adopted within two years after exit day (listed in the Schedule to the Bill). The FMLC is grateful for the opportunity to highlight some issues of legal uncertainty which are likely to arise in relation to Clause 1 of the Bill.
“In-flight” technical standards

The “in-flight” legislation listed in Clause 1(2) does not take into account those pieces of E.U. Level 2 legislation—like Commission Delegated Regulations which implement regulatory technical standards ("RTS") issued by European Supervisory Authorities in support of Level 1 legislation—that do not come into effect before exit day and will not therefore be retained under the Withdrawal Act. Anticipating this, HM Government has, by way of the Financial Regulators’ Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (the “Financial Regulators’ Powers Regulations”), bestowed upon the Financial Conduct Authority (the “FCA”), the Prudential Regulation Authority (the “PRA”), the Bank of England and the Payment Systems Regulator (collectively the “regulators”) the power to make “standards instruments” prescribing U.K. binding technical standards (“U.K. BTS”). “Onshoring” statutory instruments published under the Withdrawal Act contain provisions permitting regulators to make such BTS.3

In the FMLC letter mentioned above, the Committee had drawn attention to one such example: Directive 2015/2366/EU on payment services in the internal market ("PSD2") entered into force on 12 January 2016 and came into application from 13 January 2018 (and so will be preserved in domestic legislation under Clause 2 of the Withdrawal Act). The associated Level 2 measures—i.e., Commission Delegated Regulations—reflecting RTS will not, however, all come into force before exit day, and so will not all be received into domestic legislation under the Withdrawal Act. To address this gap, HM Treasury has made provision in regulation 51 of the Electronic Money, Payment Services and Payment Systems (Amendment and Transitional Provisions) (EU Exit) Regulations 2018 by way of a new regulation 106A inserted in the Payment Services Regulations 2017 (which originally implemented PSD2 in the U.K.), providing that the FCA “may make technical standards” on strong customer authentication and secure communication. The FCA has issued a consultation on its approach to RTS under PSD2.4

This method of incorporating Commission Delegated Regulations (which are subject to objections from the European Council and Parliament) through U.K. BTS gives rise to concerns about oversight and predictability.5 While the regulators are required to hold market consultations ahead of issuing technical standards, the only oversight of these new exit instruments, published in accordance with regulation 3(1) of the Financial Regulators’ Powers Regulations, would come from HM Treasury, which has been provided an “approval” function under regulation 5(5) of those Regulations. According to the Financial Services and Markets Act 2000, as amended by regulation 7 of the Financial Regulators’ Powers Regulations, these standards instruments will then be laid before Parliament, apparently without a specified period for objections.

This arguably leads to a lack of democratic overview of decisions taken by the regulators to track or diverge from E.U. technical standards. Such decisions could, as a result, be taken on a case-by-case basis, although the collective effect of these decisions may ultimately affect firms’ access to E.U. markets via minimum requirements in E.U. law on adequacy and equivalence.6 The FMLC would be grateful for confirmation that HM Treasury’s assessment will consider both the cumulative and granular effect of any provisions in U.K. BTS which depart from E.U. technical standards.

On a more practical note, the FMLC would question the exercise of such powers in respect of E.U. measures incorporating standards which have already been subject to the rigours of the consultative European legislative process pre-exit day. Market participants have prepared to comply with such E.U. technical standards as have been agreed ahead of exit day, and the lack of predictability about the form of U.K. BTS to be issued by the regulators begets market uncertainty.
The FMLC would therefore encourage HM Treasury to ensure continuity of regulatory regime by including “in-flight” technical standards within the permits of Clause 1 of the Bill.

“In-flight” legislation not specific to financial markets

A second complexity arises because the list in Clause 1 of the Bill limits the scope of HM Treasury’s power to make regulations to implement “in-flight” legislation to only those identified therein. The FMLC is given to understand that the list sensibly comprises only those pieces of “in-flight” legislation which would fall under the purview of HM Treasury. The effect of this, however, is that those pieces of “in-flight” legislation which are not specific to financial services but which nevertheless impose obligations and requirements on financial markets participants will not be implemented by this means post-Brexit.

An example of this is Directive (EU) 2017/828 as regards the encouragement of long-term shareholder engagement (the “Shareholder Rights Directive II”) which entered into force in June 2017 and must be implemented in national law across E.U. Member States by 10 June 2019 (which means it will not be incorporated into U.K. law under the Withdrawal Act). The Bill does not make provision for the eventual implementation of the Shareholder Rights Directive II as it is not directly financial services legislation. The Shareholder Rights Directive II, however, introduces new obligations for institutional investors and asset managers to develop and publicly disclose a policy on shareholder engagement. There are likely to be other similar pieces of “in-flight” legislation which are not directly related to the financial markets. The FMLC would be grateful for clarification on the approach which will be taken to implement such “in-flight” legislation.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

Joanna Perkins
FMLC Chief Executive

By way of (non-exhaustive) example, see:

• Regulation 71 of the draft Official Listing of Securities, Prospectus and Transparency (Amendment etc.) (EU Exit) Regulations 2019 grants powers to the FCA to make technical standards for the purposes set out in Part 3 of Schedule 2 of the SI;

• Regulation 12 of the draft Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2018 introduces new regulation 69A in the Alternative Investment Fund Managers Regulations 2013, which empowers the FCA to make technical standards for the purposes set out in Part 3 of Schedule A1 of the 2013 Regulations; and

• Regulation 4(3) of the draft Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018 introduces powers for the Bank of England and FCA to make technical standards on information for recovery plans in new Article 7(3A) and (3B) of the Bank Recovery and Resolution (No.2) Order 2014.


See also: regulations 223-226 of the draft Capital Requirements (Amendment) (EU Exit) Regulations 2018 grant powers to the FCA and PRA to make various technical standards under the onshored capital requirements regime, some of which relate to empowerments where the European Banking Authority has not currently made technical standards.

The FMLC notes that a similar point was made in the House of Lords debate in relation to the terminology used in the Bill allowing HM Treasury to make regulations “corresponding, or similar, to” the provisions specified in clause 1(2) with any adjustments it considers “appropriate” including those necessitated by the U.K.’s withdrawal from the E.U.

The FMLC is grateful to Laura Douglas of Clifford Chance LLP for her comments and suggestions on the letter.