

30 August 2017

Eral Knight
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Ministry of Justice
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Dear Mr Knight,

European Union (Withdrawal) Bill 2017

Thank you for your email to Lord Walker, dated 14 July 2017, regarding the introduction of the European Union (Withdrawal) Bill 2017 (the "Withdrawal Bill").¹ In your email—which provided helpful context—you invited the Financial Markets Law Committee (the "FMLC" or the "Committee") to discuss the Withdrawal Bill. Lord Walker and the Committee have asked me to respond to this invitation.

The role of the FMLC 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. At this early stage, the FMLC would like to draw attention to issues of legal uncertainty arising out of Clause 3 of the Withdrawal Bill.

Under Clause 3 subsection (1), "**direct E.U. legislation**"² forms part of domestic law on and after **exit day**,³ provided that it is "operative immediately before exit day". Clause 3 subsection (3) clarifies that 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;
- b. in the case of a decision which specifies to whom it is addressed, it has been notified to that person before exit day; and
- c. in any other case, it is in force immediately before exit day.

Direct E.U. legislation which applies section by section

Paragraph 84 of the Explanatory Notes to the Withdrawal Bill comments that this Clause 3 subsection (3) operates to ensure that E.U. legislation—where it comes into application section by section, in a staggered way over time—will be converted into domestic legislation only in so far as the instrument has entered into force and applies before exit day.⁴ Where the date of application of a provision falls after exit day, the provision will not be converted into domestic law.

It is the view of the FMLC that this approach introduces legal uncertainty on a number of fronts. First and foremost, it results in an increase in complexity for market participants attempting to establish which legal obligations apply to them. The need to decouple the provisions of direct E.U. legislation which are "operative immediately before exit day" from those in the same measure which are not, and then interpret the resultant part-legislation (which may make reference to provisions that are not "operative immediately

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before exit day”) received into domestic law will place no small burden on market participants, and could introduce significant uncertainties.

Secondly, this approach will result in a divergence between U.K. and E.U. legislation in fairly short order. Where the U.K. prefers to keep in line with the direction of E.U. legislation—particularly in those situations where the U.K. wishes to and expects to attract an “equivalence” decision from the European Commission⁵—the approach taken in Clause 3 of the Withdrawal Bill will require the U.K. to implement separately any relevant E.U. provisions in direct legislation which had not come into application before exit day. In practice, such a process may lead to considerable legal uncertainty. For example, a situation could arise where the U.K. government signals its intention to implement a particular E.U. provision in direct legislation which had not come into application before exit day. Such a provision could, however, become applicable in the E.U. at a date before the U.K. has had time to implement it domestically. This would leave market participants unsure as to their obligations.

The FMLC recommends, therefore, that further careful thought be given to the mechanics and operation of Clause 3 of the Withdrawal Bill. In particular, the legal uncertainty arising from the distinction it draws between the provisions of direct E.U. legislation that apply before exit day, and those which do not, must be managed. One solution might be to adjust the wording of Clause 3 subsection (3) so that direct E.U. legislation which has come into force before exit day (even if it is not yet applicable) will be considered “operative immediately before exit day”, and so incorporated into domestic law under Clause 3 subsection (1) of the Withdrawal Bill. This inclusion could be subject to the caveat that such direct E.U. legislation will only apply domestically from the time at which it would have otherwise applied under its native E.U. timetable.

Later application of implementing and regulatory technical standards

Similar points may be made in respect of those E.U. legislative acts, such as implementing regulations, which are often referred to as “Level 2” measures designed to enhance and clarify “Level 1” directives and regulations. Described as “tertiary legislation” in the Explanatory Notes, these measures are typically drafted first—in a financial services context—as regulatory and implementing technical standards (“RTS” and “ITS”, respectively) by the European Supervisory Authorities (the “ESAs”)⁶ and adopted by the European Commission.

Where E.U. measures reflecting RTS and ITS are not received into domestic law *via* the Withdrawal Bill—owing to the fact that they are not in force or do not apply before exit day—the issues of legal uncertainty described above are thrown into sharper relief. This is because, without the benefit of particular RTS and/or ITS, Level 1 regulations and directives that become part of domestic law through the Withdrawal Bill simply may not function properly.

This point can be illustrated with the example of Directive 2015/2366/EU on payment services in the internal market (“PSD2”). PSD2 entered into force on 12 January 2016 and will apply from 13 January 2018 (and so will be preserved in domestic legislation under Clause 2 of the Withdrawal Bill).⁷ The associated measures reflecting RTS on strong authentication and secure communication will not, however, come into force before exit day, and so will not be received into domestic legislation.⁸ Yet these RTS are, as the EBA itself states, key to achieving the objectives of PSD2 of enhancing consumer protection, promoting innovation and improving the security of payment services across the E.U.;⁹ in their absence, it will be difficult for market participants to implement PSD2 effectively.

Such legal uncertainty is only amplified by the opacity surrounding the manner in which the role of the ESAs will be replicated in the U.K. after exit day. Which U.K. bodies (if any) will take on mantle of the ESAs after exit day, and whether they will take up the task of drafting similar standards, and with what resources, is far from clear. For example, it

could be that—initially—whoever is deemed responsible for these standards will have a policy of tracking the wording of RTS and ITS produced by the ESAs until such as time as they have sufficient resources to produce standards themselves. Alternatively, from the very beginning, domestic standards could be produced in lieu of E.U. RTS and ITS. The lack of clarity on the applicable structures and mechanisms makes it difficult for market participants to anticipate how tertiary legislation will operate with respect to E.U. regulatory regimes which have only partly been received after exit day.

In addition to its recommendations above, therefore, the FMLC suggests that the U.K. Government clarifies which U.K. bodies (if any) are to take on the role of the ESAs, how this role will be defined (to include any potential role in the production and oversight of equivalent RTS/ITS legislation), and how this will be resourced as soon as possible. It may also be prudent to have a plan in place for those situations where—as with PSD2—particular RTS or ITS are required to enable domestic legislation to function effectively.

With these exceptions, the FMLC declines to comment on the Withdrawal Bill at this time, believing that—given its expertise in issues of legal uncertainty—it can most usefully contribute research and analysis when the statutory instruments made pursuant to powers set out in the Withdrawal Bill are published.¹⁰

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 to arrange such a meeting or should you require further information or assistance.

Yours sincerely,



Joanna Perkins
FMLC Chief Executive

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- ¹ The European Union (Withdrawal) Bill 2017 is available at <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0005/18005.pdf>. The progress of the Withdrawal Bill can be monitored at <http://services.parliament.uk/bills/2017-19/europeanunionwithdrawal.html>.
- ² Under Clause 3 subsection (2) of the Withdrawal Bill, “direct EU legislation” includes any E.U. regulation, E.U. decision or E.U. tertiary legislation, subject to certain carve-outs, as it has effect in E.U. law immediately before “exit day”, *infra* n.3.
- ³ Under Clause 14 of the Withdrawal Bill, “exit day” means “such day as a Minister of the Crown may by regulations appoint”.
- ⁴ European Union (Withdrawal) Bill 2017 Explanatory Notes, available at <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0005/en/18005en.pdf>.
- ⁵ For more information on third country regimes in E.U. legislation, see the FMLC’s paper entitled “Issues of Legal Uncertainty Arising in the Context of the Withdrawal of the U.K. from the E.U.– the Provision and Application of Third Country Regimes in E.U. Legislation” (13 July 2017), available at http://www.fmlc.org/uploads/2/6/5/8/26584807/fmlc_paper_on_brexit_and_third_country_regimes.pdf.
- ⁶ The ESAs comprise the European Securities and Markets Authority (“ESMA”), the European Banking Authority (“EBA”) and the European Insurance and Occupational Pensions Authority (“EIOPA”).
- ⁷ Information about PSD2 can be found on the European Commission’s website at https://ec.europa.eu/info/law/payment-services-psd-2-directive-eu-2015-2366/law-details_en.
- ⁸ A visual aid showing European Banking Authority (“EBA”) mandates in PSD2 and their timelines, produced by the EBA, is available here: <https://www.eba.europa.eu/documents/10180/87703/EBA+Mandates+PSD2.pdf/5c2493a4-ef26-4434-8338-736895bd423f>.

⁹ See EBA "Discussion Paper on future Draft Regulatory Technical Standards on strong consumer authentication and secure communication under the revised Payment Services Directive (PSD2)" EBA/DP/2015/03 (8 December 2015) p.4 <https://www.eba.europa.eu/documents/10180/1303936/EBA-DP-2015-03+%28RTS+on+SCA+and+CSC+under+PSD2%29.pdf>.

¹⁰ For further information as regards these powers, see Clauses 7 -10, 17 and Schedules 2 and 7 of the Withdrawal Bill.