Dear Nicky

Financial Services EU Exit – proposed division of responsibility for EU financial services regulation

At Treasury oral questions this week, you asked about the ‘onshoring’ of EU financial services regulation, and in particular how the onshoring of EU Binding Technical Standards (BTS) would be carried out in a way which is accountable to Parliament. I am writing to provide more information on the proposed approach to the onshoring of EU financial services regulation, which I hope you will find useful.

As you know, a significant part of the regulatory and supervisory framework for financial services derives from EU law. This body of EU rules will need to be domesticated as we prepare to leave the EU. The European Union (Withdrawal) Act will incorporate directly applicable EU law into UK law, save relevant domestic legislation, and delegate powers to Ministers to fix ‘deficiencies’ in that law using secondary legislation. As part of our work to ensure we are prepared for the unlikely scenario where the UK leaves the EU in March 2019 with no implementation period, the Treasury proposes to domesticate EU rules in a way that aligns with the UK’s existing framework for financial services, as approved by Parliament in successive pieces of legislation.

The cornerstones of the UK’s financial services framework are the Financial Services and Markets Act 2000 (FSMA), the Banking Act 2009 and the Bank of England Act 1998, which set out the overall approach for financial regulation and establish the objectives, functions and responsibilities of our regulators – the Bank of England, including the Prudential Regulation Authority, and the Financial Conduct Authority. FSMA then delegates responsibility to the regulators for making the detailed rules that need to apply to firms in order to implement the framework which Parliament has set. We propose to follow this model as we onshore EU financial services legislation.

On-shored EU ‘Level 1’ legislation, which has been developed by the Commission and negotiated through the Council of the EU and European Parliament, would become the responsibility of the UK Parliament. This level of EU regulation sets 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. The Treasury will propose amendments to this legislation, using powers to make secondary legislation under the EU (Withdrawal) Act, ensuring that Parliament is asked to approve the changes that are needed to ensure this legislation operates effectively after exit. It is expected that the vast majority of the statutory instruments needed to correct deficiencies in this legislation will be laid under the affirmative procedure, so there will be opportunity for debate in Parliament on the proposed approach.

Underneath EU Level 1 legislation, there is a large body of EU technical rules known as Binding Technical Standards (BTS). As set out in EU legislation, these BTS are “technical” and “shall not imply strategic decisions or policy choices”. The Treasury proposes to allocate responsibility for these BTS to UK regulators, with that responsibility to be exercised in broadly the same way that UK regulators are already responsible for detailed domestic technical rules. Having played an important role in the EU to develop BTS, UK regulators have the necessary expertise and resource to maintain them.

In April, the Treasury published a draft statutory instrument which we plan to lay before Parliament shortly, using the affirmative procedure. The instrument sets out the basis on which Parliament will be asked to approve the allocation of responsibility for BTS to UK regulators. A copy of the draft instrument and an explanatory note is attached.

In summary, the instrument will:

• Permit UK regulators – the Bank of England (including the Prudential Regulation Authority), the Financial Conduct Authority and the Payment Systems Regulator - to use the deficiency fixing power in the EU (Withdrawal) Act to correct deficiencies in onshored BTS, and in existing UK regulator rules (made under FSMA) that currently implement EU law. The regulators will be given the task of ensuring that deficiencies in these rules are corrected to be consistent with the fixes that Parliament will be asked to approve in Level 1 legislation.

• Give UK regulators responsibility for maintaining BTS after exit, on a similar basis as they currently exercise their function for making domestic rules, following established requirements approved by Parliament in FSMA.

• Specify which UK regulator will become responsible for each ‘onshored’ BTS. Where UK regulators will have joint responsibility for BTS, there will be a procedure that must be followed to ensure that both regulators are appropriately involved when amendments need to be made.

It is of course right that the UK regulators take on responsibility for correcting and maintaining BTS in a way which is consistent with the policy direction set by the Treasury

¹ Article 10(1) sub-paragraph 2 and Article 15(1) sub-paragraph 1 of the ESA Regulations (Regulation 1093/2010, Regulation 1094/2010 and Regulation 1095/2010).
and Parliament. The following constraints will therefore apply to the regulators’ exercise of this responsibility:

- When fixing BTS deficiencies to ensure that onshored BTS operate effectively from exit, Treasury is required to approve all of the instruments which will give effect to those fixes. Treasury ministers will be responsible for ensuring that the deficiency fixes are consistent with the amendments made to parent legislation, which Parliament will be asked to approve in SIs made under the EU (Withdrawal) Act.

- The regulators plan to conduct public consultations on their proposed deficiency fixes and the consultation process should begin in the autumn, subject to Parliament approving the regulators having responsibility for this task. As well as giving industry an opportunity to express views on the proposed BTS amendments, the regulators consultation documents will be available to relevant Parliamentary committees, including the Treasury Select Committee, to give these committees an opportunity to engage with proposed deficiency fixes, should they wish to do so.

- In the affirmative SIs that Treasury will be laying under the EU (Withdrawal) Act, Parliament will be asked to approve each of the specific and limited purposes for which the regulators will take on responsibility for BTS. For example, the technical standard made under Article 78 of the Capital Requirements Directive is for setting out consistent standards on templates, definitions and IT formats that firms should use when reporting supervisory information to regulators. The regulators will only be able to take on responsibility for this specific technical standard if Parliament approves it. The regulators will not be able to make or amend BTS in areas that Parliament has not specifically approved.

- The regulators will be subject to existing statutory consultation requirements under FSMA to consult on any proposed changes to BTS after exit. These requirements include consultation accompanied by cost/benefit analysis which should assess the impact on firms.

- If the regulators propose a change to BTS after exit which appears to the Treasury to have implications for public funds, or which appears to the Treasury to prejudice the negotiation of any international agreement on financial services, including negotiations with the EU, the Treasury will have the ability to veto such a proposal. Parliament will of course be able to hold ministers accountable for how this veto is exercised.

- As required by the EU (Withdrawal) Act, any non-ministerial body to which a power under the Act is delegated must provide an annual report to both Houses of Parliament, explaining how the delegated power has been exercised. The Treasury will ensure that the reports provided by the UK’s financial regulators are sent to the relevant Parliamentary committees, including the Treasury Select Committee.
The scrutiny of the regulators' work by the Treasury Select Committee is integral to the regulators' accountability and transparency. This will of course apply to the functions being conferred on them in relation to BTS.

I hope you will agree that the proposed approach is a sensible and appropriate division of responsibility for onshored EU financial services rules, which ensures Parliament will remain responsible for setting the direction of financial services policy, with regulators responsible for maintaining technical rules which follow that direction.

It must be emphasised that this division of responsibilities is part of the Treasury's overall approach to ensure there is a fully functioning financial services regime in place at the point of exit. When the time is right, I look forward to the Treasury Select Committee playing an important role in helping to develop an optimal long-term framework for the UK.

I hope you find this information helpful and I would be grateful for your views on our proposed approach, particularly on how we ensure that Parliament is appropriately involved in the work to onshore BTS.

A copy of this letter has been placed in the Libraries of the House.

PHILIP HAMMOND