A New UK Regulatory Landscape? HM Treasury lays the Financial Services and Markets Bill 2022-23 before Parliament

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On 20 July 2022, just over 18 months after the end of the transition period that marked the UK's full departure from the EU, HM Treasury laid the Financial Services and Markets Bill 2022-2023 (the **Bill**)[1] before Parliament for its first reading. The Bill sets out the UK government's post-Brexit regulatory framework, as well as putting forward a number of proposals that make significant amendments to existing UK regulation. Brexit has, to date, not resulted in meaningful difference between the EU and UK's regulatory regimes so it is of no surprise that the publication of the Bill – that sets the UK on a path that will see it diverge from the EU – has attracted a lot of attention.

This OnPoint provides a high-level overview of some of the key elements of the Bill[2].

What does the Bill propose?

Regulatory Framework and the Revocation of retained EU law – The Bill enables HM Treasury and the UK's financial services regulators, namely the Prudential Regulation Authority (**PRA**), the Financial Conduct Authority (**FCA**) and Bank of England (**Bank** and together with the PRA and FCA, the **UK Regulators**) to revoke retained EU law and replace it with legislation designed specifically for UK markets.

New Regulatory Powers – The Bill enhances the financial services regulatory framework as set out in the Financial Services and Markets Act 2000 (**FSMA**).

New Objectives and regulatory principles – The Bill enhances the framework of objectives and principles that guide UK Regulators' actions.

Accountability of Regulators – The Bill introduces a requirement for the UK Regulators to respond annually to recommendations made by HM Treasury under existing provisions in FSMA. The Bill also introduces a formal requirement for the UK Regulators to keep their rules under review.

Performance of functions relating to financial market infrastructure – The Bill extends the senior managers and certification regime (**SM&CR**) to central counterparties (**CCPs**) and central securities depositories (**CSDs**) and provides the relevant UK Regulators (in this case the Bank or the FCA) with new powers to implement, supervise and enforce the new regime.

Central counterparties in financial difficulties – In line with the 2017 Financial Stability Board guidance for recovery and resolution of CCPs, the Bill makes provision for a special resolution regime for CCPs where all or part of their business encounters financial difficulties. The provisions introduced by the Bill contain some, but not all, elements of the European regulation on a framework recovery and resolution of CCPs[3] that was in draft form when the UK left the EU.

Insurers in financial difficulties – The Bill expands the protections available to an insurer and its policyholders undergoing insolvency or write-down procedures. In particular it allows the insurer, a shareholder, policyholder or other creditor to apply to court for a write-down order. The court may make the write-down order if it is satisfied that the insurer is, or is likely to be, unable to pay its debts and that the write-down is reasonably likely to lead to a better outcome for the policyholders and creditors taken as a whole.

Access to Cash – The Bill protects access to cash for consumers and businesses by ensuring the continued provision of cash withdrawal and deposit facilities across the UK.

Miscellaneous provisions – The Bill includes a number of miscellaneous provisions including for example disciplinary action against formerly authorised persons.

In more detail….

Regulatory Framework and the Revocation of retained EU law – The Bill establishes the framework as set out in the Future Regulatory Framework (**FRF**) review of moving retained EU law – which includes a large number of detailed regulatory requirements in the primary legislation – off the UK's statute books and onto the rulebooks of the UK Regulators. This would follow the existing FSMA model.

The revocation of EU law is not immediate and would not take place until the FCA and/or PRA have drafted and consulted on replacement rules and those rules are ready to be put in place. This is a process which the government has indicated will take place over years not months or weeks.

New Regulatory Powers – Under this heading, the Bill introduces (i) a Designated Activities Regime (**DAR**); (ii) a "regulatory gateway" for approving financial promotions; and (iii) proposals relating to Digital Assets.

- **DAR** – The Bill creates a new Designated Activities Regime (**DAR**). There are notable similarities between the DAR and the existing regulated activities regime - established under FSMA and the FSMA 2000 (Regulated Activities) Order 2001. The DAR will enable HM Treasury to designate activities related to financial markets exchanges, instruments, products, or investments, so as to bring them into regulation. Where an activity has been designated, anyone conducting that activity will be required to follow the rules for that activity, unless they are exempt. The Bill prohibits the carrying out of designated activities unless in accordance with the relevant rules. The legislative framework for the DAR will be set out primarily in a new Part 5A to FSMA.
- **Regulatory gateway for approving financial promotions** – The Bill establishes a 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 current UK financial promotions regulatory regime seeks to ensure that consumers are provided with clear and accurate information that enables them to make appropriate decisions for their individual circumstances. Authorised firms have a responsibility to ensure that any financial promotions they approve are compliant with relevant FCA rules, but any authorised firm can approve any financial promotion of an unauthorised firm and there is no specific suitability test or assessment that the authorised firm has to meet in order to do so. In June 2020, HM Treasury consulted on limiting the scope of firms that can approve the financial promotions of unauthorised persons. The consultation response, issued in June 2021, confirmed HM Treasury's intention to amend the financial promotion approval regime by establishing this regulatory gateway now established by the Bill for the approval of unauthorised persons' promotions.
- **Digital Assets** – The Bill gives HM Treasury a power to bring digital settlement assets used for payments and the service providers and exchange providers connected with digital settlement assets into the UK regulatory perimeter. A "digital settlement asset" is a new concept, defined as a digital representation of value or rights, whether or not cryptographically secured, that satisfies certain specified conditions. The Bill will also bring 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.

The explanatory notes[4] to the Bill state that the government intends to launch a consultation on its regulatory approach to wider cryptoassets beyond stablecoins used for payments, including those primarily used as a means of investment (such as Bitcoin) later in 2022.

What else?

Regulation of CCPs and CSDs by the Bank of England – The Bill introduces a general rule-making power for the Bank over CCPs and CSDs, enabling it to take primary responsibility for setting the regulatory requirements for these entities. An adjusted set of statutory objectives and principles ensures that the Bank considers the appropriate public policy objectives when exercising this power. At present, the Bank has limited powers to set direct regulatory requirements on these entities as they are currently governed by retained EU law, notably the European Market Infrastructure Regulation (**EMIR**) and the Central Securities Depositories Regulation (**CSDR**).

Wholesale capital markets regulation – In July 2021, following the UK's exit from the EU, the government launched the Wholesale Markets Review (**WMR**) consultation with the aim of creating a simpler and less prescriptive regime that meets the needs of UK markets while maintaining high regulatory standards. The Bill delivers the priority measures identified by the WMR consultation and aims to improve competitiveness and increase the flexibility of wholesale markets regulation by making nine sets of changes to the Markets in Financial Instruments Directive (**MiFID II**) framework. Three of the nine changes[5] are detailed below:

- **Share Trading Obligation** – One of the regulatory changes introduced by MiFID II was the introduction of a new requirement known as the Share Trading Obligation (**STO**)[6]. Under the STO, no investment firm may execute a trade in shares admitted to trading on a UK regulated market (**RM**), or traded on a UK trading venue, unless that trade takes place on a UK RM, multilateral trading facility (**MTF**), or systematic internaliser, or an equivalent third-country trading venue. In December 2020, the FCA exercised its temporary transitional power (**TTP**)[7] to modify the requirements of the STO, allowing investment firms to trade in shares subject to the STO on or through EU trading venues and systematic internalisers. The Bill permanently removes the STO.
- **Alignment of the DTO under MiFIR with the EMIR clearing obligation** – The Bill realigns the scope of the derivatives clearing obligations and trading obligations (**CO** and **DTO** respectively)[8] following divergence caused by the so called "EMIR Refit" changes to the scope of the CO in 2019 and also amends EMIR to introduce an exemption to the CO mirroring the exemption to the DTO.
- **FCA power to modify or suspend the DTO** – The FCA has used the TTP to make a transitional direction modifying the DTO to allow certain counterparties to use EU venues when trading with an EU client who does not have access to a venue to which both the UK and EU have granted equivalence. The Bill empowers the FCA to suspend or modify the DTO outside the limited purpose and time limit constraints of the TTP. Subject to certain conditions, the FCA may modify the DTO in respect of any of its three fundamental components, and subject to conditions. For example, the FCA will be able to direct that, for a certain period, certain persons to whom the DTO would normally apply are not bound by the DTO provided that they meet any conditions laid out in the direction.

Amendments to the EU Securitisation Regulation 2017 – Under the UK Securitisation Regulation, certain securitisations can be designated as Simple, Transparent and Standardised (**STS**). The Bill allows STS equivalent non-UK securitisations to be recognised in the UK if HM Treasury is satisfied that the law and practice which applies in the country applicable to the securitisations has equivalent effect to UK law and that there are effective cooperation arrangements with the competent authorities in that country or territory. HM Treasury will need to make a regulation in relation to designating a third country or territory as equivalent. These regulations can include, among other things, additional diligence requirements for investors.

Currently, in order for a securitisation to be designated as STS, the UK Securitisation Regulation requires the originator and sponsor of an STS securitisation to be established in the UK. In addition, securitisations designated as STS under the EU Securitisation Regulation (with the originator and sponsor in the EU) before 31 December 2022 are also recognised as STS in the UK for the lifetime of the securitisation. Under the UK Securitisation Regulation, securitisations with originators and sponsors established outside the UK (or the EU until 31 December 2022) cannot be designated as STS. As a result, CRR firms[9] and Solvency II firms[10] cannot get preferential capital treatment for investing in those securitisations originated overseas, even if this is appropriate, because of their adherence to STS criteria. As noted above, the provisions in the Bill will allow HM Treasury to make regulations to vary these limits on the availability of STS securitisations for UK investors.

What next?

On 11 August 2022, Andrew Bailey, Governor of the Bank, sent a letter (dated 27 July 2022)[11] supporting the proposals for regulators to have increased responsibility for setting regulatory requirements. The letter also stated that the PRA expects to publish a discussion paper in September, setting out the PRA's vision for implementing the framework as it currently stands.

The next stage in the legislative process is for the Bill to have its second reading in Parliament, currently scheduled for Wednesday 7 September 2022.

There is no strict timeline for the Bill to complete its passage through Parliament and the House of Lords and receive Royal Assent. Although by way of comparison the other major piece of post-Brexit legislation, the Financial Services Bill 2019-2022, took at least six months to receive Royal Assent.

We can be certain that change is afoot but not immediately, and the finer details of any changes remain to be seen.

Footnotes

The Bill, as introduced to the House of Commons on 20 July 2022, is available here.

The Bill is a lengthy 335 pages long and is accompanied by explanatory notes that run to 237 pages. The explanatory notes, which relate to the Bill as introduced to the House of Commons on 20 July 2022 are available here.

Regulation (EU) 2021/23.

Ibid 3.

The other six changes relate to: (i) replacing the pre-trade transparency waiver regime and removing the Double Volume Cap; (ii) changing the definition of a systematic internaliser; (iii) removing restrictions on midpoint crossing for trades; (iv) exempting for post-trade risk reduction services from the DTO; (v) simplifying the transparency regime for fixed income and derivatives; and (vi) simplifying the position limits regime.

Article 23 of the Markets in Financial Instruments Regulation (MiFIR).

HM Treasury gave UK financial regulators the power to make temporary transitional provisions in relation to financial services legislation – known as temporary transitional power (TTP), and the use of the TTP is set out in FCA directions. Under the TTP, firms and other regulated persons can continue to comply with their pre-existing requirements for a limited period.

The DTO requires financial counterparties and some non-financial counterparties to trade certain classes of derivatives on UK authorised trading venues, or overseas trading venues that have been recognised as equivalent. The CO requires certain OTC derivative contracts (as defined in EMIR) to be cleared by an authorised CCP. The way in which MiFIR frames the scope of the DTO draws heavily on EMIR. A financial counterparty is a regulated financial services firm falling within one of the seven categories specified in Article 2(8) EMIR and a non-financial counterparty is an entity established in the UK that is not a financial counterparty or a CCP (see Article 2(9) EMIR).

CRR firms are firms (for example, banks, building societies, and PRA-designated investment firms) that are subject to prudential requirements in the Capital Requirements Regulation and relevant PRA rules.

Solvency II firms are insurance firms that are subject to prudential requirements under the Solvency II regime.

The letter from Andrew Bailey is available here.

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