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THE FUTURE REGULATORY FRAMEWORK FOR FINANCIAL SERVICES

A commentary on HM Treasury's proposals

Amar Johal
with Ibrahim Babiker and Alex Gewanter

About the authors

Amar Johal is a lawyer specialising in financial services and EU law.

Ibrahim Babiker is a lawyer specialising in financial restructuring in London and Hong Kong.

Alex Gewanter is a banking lawyer working in London.

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FOREWORD

One of the effects of the UK's membership of the EU is that whole swathes of Government policy were in effect outsourced to the EU. Whether that form of outsourcing was good, bad or indifferent is a matter for another day, and perhaps lies outside the legal focus of the Society of Conservative Lawyers, but as this paper makes clear, leaving the EU means the UK has to put in place laws and regulations to fill the space previously occupied by EU law.

Nowhere is this more important than in the area of the regulation of financial services, which are central to our economy. As the authors explain, the EU Withdrawal Act gave the Treasury rather limited powers, essentially transferring powers carried out by the EU to the regulators. But there was no root and branch review of the purpose, process or structure of such regulation.

Against that background, the Future Regulatory Framework (FRF) now seeks to construct a new regulatory environment which is suitable for a post-Brexit UK. The authors term this project "ambitious" – and they are no doubt correct in that assessment. But we are going to need ambition in this and other areas if we are to make full use of the opportunities which leaving the EU affords the UK.

Opportunities – and also challenges, as this paper highlights. Being a member of the EU meant that the UK didn't have to (or was prevented from) doing some things on its own. Some political and administrative muscle-density was lost during that period, as other entities undertook work and fulfilled tasks which UK entities and institutions used to do. And rather like someone who's decided to go back to the gym, reacquainting ourselves with the use of those political and administrative muscles might be a little painful at first – but the country will be fitter and healthier in the long run.

As the authors conclude, the key issue will be to translate the broad principles set out in the FRF into detailed primary and secondary legislation, and no doubt even more detailed regulatory rules. They promise us to keep an eye on how that task is carried out – and so I look forward to benefitting from their follow-up paper as much as I have gained from reading this one.

David Wolfson

Lord Wolfson of Tredegar Q
One Essex Court
Parliamentary Under Secretary of State for Justice December 2020 to April 2022

INTRODUCTION

On 31 January 2022, the Prime Minister announced a "*major cross-government drive to reform, repeal and replace outdated EU law*".[1] How this is done in practice will depend on the sector, but arguably the most ambitious of these drives is HM Treasury's proposed Future Regulatory Framework for financial services ("FRF"). Financial services is an area where there is real scope to exploit the UK's position outside the EU, and the UK needs a legislative framework that is capable of delivering the ambitious policy goals that the Chancellor set out in his 2021 Mansion House speech, including improving ties with financial centres around the world, becoming a leader in green finance, and being at the forefront of financial technology and innovation.[2]

The FRF contains a number of proposals to reform financial regulation in the UK; the most significant and interesting from a legal perspective is HM Treasury's plan to revoke and restate virtually all retained EU financial services law.[3] In order to achieve its objectives, HM Treasury will need to balance different competing interests and pressures during the drafting and passage of implementing legislation, which was announced as part of the Queen's Speech on 10 May 2022.

It is difficult to understate how momentous a legal project this is: there is a vast body of retained EU financial services law, estimated to run to over 10,000 pages.[4] The FRF will involve re-centring financial regulation around the Financial Services and Markets Act 2000 ("FSMA") model, which was the basis for financial regulation in the UK before a vast suite of post-2008 EU legislation altered the regulatory landscape. To understand the scale of the FRF and what it aims to achieve, it is therefore necessary first to summarise the FSMA framework and how EU financial services legislation impacted it.

[1] Press release: Prime Minister pledges Brexit Freedoms Bill to cut EU red tape, Prime Minister's Office, 31 January 2022: www.gov.uk/government/news/prime-minister-pledges-brexit-freedoms-bill-to-cut-eu-red-tape

[2] Mansion House Speech 2021, Rt Hon Rishi Sunak MP, 1 July 2021: www.gov.uk/government/speeches/mansion-house-speech-2021-rishi-sunak; A new chapter for financial services, HM Treasury, July 2021: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/998102/CCS0521556086-001_Mansion_House_Strategy_Document_FINAL.pdf

[3] Retained EU law means direct EU legislation (principally EU regulations) incorporated by the European Union (Withdrawal) Act 2018 (EUWA) or EU-derived domestic legislation saved by the EUWA.

[4] Brexit: the future of financial regulation and supervision, European Union Committee, January 2018, para. 65: https://publications.parliament.uk/pa/ld201719/ldselect/ldeucom/66/6606.htm#footnote-288

HISTORY OF FINANCIAL REGULATION IN THE UK AND FSMA

Before 2000, financial regulation in the UK was based on a patchwork of statutes, voluntary codes and regulatory bodies, many of which were industry self-regulation bodies. The Financial Services Act 1986 started the move to place more of the regulatory regime on to a statutory footing, introducing the first financial services regulator established by statute – the Securities and Investments Board, and there was further legislation in the late 1980s and early 1990s.[5]

In 1997, the Government announced proposals to coordinate and modernise these different enactments, culminating in FSMA, which created the Financial Services Authority ("FSA"). The financial crisis of 2007–8 exposed a number of weaknesses in the UK financial regulatory framework and the Government revisited the financial regulatory architecture in the Financial Services Act 2012 ("2012 Act"), leading to the

[5] Financial Services Future Regulatory Framework Review Phase II Consultation, HM Treasury, October 2020, p.11: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/927316/141020_Final_Phase_II_Condoc_For_Publication_for_print.pdf

bifurcation of the FSA into the Financial Conduct Authority ("FCA") and Prudential Regulation Authority ("PRA"), the latter sitting in the Bank of England.

The UK adopted the so-called 'twin peaks' model of separate conduct and prudential regulation: the FCA is tasked with regulating the conduct of business, focusing on market integrity, consumer protection and promoting competition; the PRA is designated as the micro-prudential regulator, regulating institutions that manage significant risks on their balance sheets (e.g. banks and insurers). The 2012 Act also established a Financial Policy Committee within the Bank of England with responsibility for macro-prudential regulation (monitoring the stability and resilience of the system as a whole). A Payments Systems Regulator ("PSR") was then created in 2013 as an independent subsidiary of the FCA to regulate payment services.[6]

The basic principles of the FSMA regime are as follows:

An independent regulator – FSMA established the FSA (later split into the FCA and PRA), merging 11 regulatory bodies into one operationally independent regulator with responsibility for setting the detailed requirements that apply to regulated firms and markets.[7]

Statutory objectives – the FCA and PRA are tasked with meeting statutory objectives and are required to further these objectives when discharging their functions (for example when making rules or issuing guidance).

The 'regulatory perimeter' – allowing HM Treasury to specify which financial activities should be subject to the regulators' oversight through secondary legislation: an activity is a regulated activity if it relates to investments or activities specified by HM Treasury in the Regulated Activities Order.[8]

General prohibition – persons are prohibited from carrying on a regulated activity in the UK unless they are authorised or exempt.

Exemptions – HM Treasury can exempt persons from the general prohibition in respect to one or more regulated activities by secondary legislation.

Application for permission – for authorisation to carry on one or more regulated activities, an application for permission must be made to the FCA or PRA; in order to be given permission firms must meet minimum requirements known as the 'Threshold Conditions'.

Rule-making powers – the regulators have the power to make rules applying to their respective authorised persons (rules are a form of subordinate legislation).

FSMA partly implemented EU legislation and treaty principles at the time. However, since it was enacted there have been a large number of directly applicable EU regulations and standalone pieces of domestic legislation implementing EU directives, which have collectively undermined the coherence of the FSMA framework.

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[6] In the rest of this paper the term 'regulators' is used to refer to the FCA and PRA. Whilst the Bank of England and the PSR are regulators, the fact that they derive their powers from outside of FSMA in most cases means that the discussion is less relevant to their legal framework.

[7] The FSA: A Review under Section 12 of the Financial Services and Markets Act 2000, National Audit Office, 30 April 2007: www.nao.org.uk/report/the-financial-services-authority-a-review-under-section-12-of-the-financial-services-and-markets-act-2000

[8] Whilst the Regulated Activities Order is not the only basis for the FCA and PRA's regulatory responsibilities, it is main piece of legislation designating the regulatory perimeter.

EU FINANCIAL REGULATION AND BREXIT

The single market freedom to provide services was implemented in financial services through the concept of the 'passport', which enables firms that are authorised in any EU (or EEA) state to provide financial services or establish branches in other member states with minimal additional authorisation requirements. Passporting rights were extended piecemeal across different financial services by directives and were implemented in Schedule 3 of FSMA.[9] Firms passporting into the UK (before the end of the transition period provided for under the UK-EU Withdrawal Agreement that continued the application of EU law in the UK until 31 December 2020) were treated as authorised persons.

Regulation up to Brexit

Before 2008 the EU had already adopted a number of legislative acts to deepen the single market for financial services, but it was the financial crisis that prompted a fundamental overhaul of the regulatory framework for financial services. From 2009–2014 the EU embarked on a massive programme of legislative action, adopting approximately 30 financial services related legislative acts (which themselves then mandated further delegated legislation) – HM Treasury estimated that this represented a ten-fold increase in financial regulation.[10]

To give an idea of the scale of these changes, the total recast market in financial instruments directive ("MiFID II") package (Directive 2014/65/EU, Regulation (EU) 600/2014, delegated regulations and guidance) was estimated to contain 1.7 million paragraphs.[11] Much of the legislation implemented the G20 crisis-era reform agenda (for example the Basel III accord on capital adequacy for banks), although some of the legislation reflected EU-specific concerns and political objectives or a desire to guarantee consistent supervision across the single market.[12] An important change in the EU financial supervision framework was the creation of the European supervisory authorities ("ESAs"): the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority.[13]

Importantly, these supervisory authorities were given powers to draft the technical standards (a category of delegated regulation) mandated or provided for by the main legislative acts or 'Level 1' regulations, even if they are ultimately adopted by the European Commission, and advise the Commission on other delegated and implementing acts.[14]

Some of these legislative acts were incorporated into the FSMA architecture but much of it did not readily fit into the existing FSMA structure: for example, MiFID II imposed obligations on market participants who were not authorised persons (and over whom the FCA therefore did not have powers), which required HM Treasury to amend the regulatory perimeter.[15] By the end of the transition period, there was a large amount of directly applicable EU law outside of the FSMA

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[9] Schedule 4 of FSMA implemented EU treaty rights to establishment and to provide financial services to the extent not covered by the directives.

[10] Review of the Balance of Competences between the United Kingdom and the European Union, The Single Market: Financial Services and the Free Movement of Capital, p.74: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/332874/2902400_BoC_FreedomOfCapital_acc.pdf

[11] Europe begins countdown to Mifid II, Philip Stafford and Peter Smith for the Financial Times, 1 January 2018: www.ft.com/content/b8a9a634-e116-11e7-a8a4-0a1e63a52f9c

[12] The post-crisis EU financial regulatory framework: do the pieces fit? – House of Lords European Union Committee, Chapter 1: https://publications.parliament.uk/pa/ld201415/ldselect/ldeucom/103/10305.htm#note17

[13] Regulations (EU) No 1092/2010,1093/2010, 1094/2010, and 1095/2010.

[14] Regulatory process in financial services, European Commission: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/regulatory-process-financial-services/regulatory-process-financial-services_en

[15] Transposition of MiFID II, HM Treasury, March 2015: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/418281/PU_1750_MiFID_II_26.03.15.pdf

architecture applying to a broader range of entities than FSMA authorised persons, notably to financial market infrastructure ("FMI"), such as credit ratings agencies or central counter parties.

Brexit – changes limited to fixing withdrawal-related deficiencies

The UK's vote to leave the EU prompted a huge exercise to review and 'onshore' direct EU legislation that would be retained by the European Union (Withdrawal) Act 2018 ("EUWA") and other EU-derived domestic legislation to make it function in a UK-only context and create a workable legal framework regardless of the outcome of exit negotiations. HM Treasury made around 60 statutory instruments using EUWA powers, and the regulators made a large number of amendments to technical standards and their handbooks (rules) under delegated powers.[16]

HM Treasury's powers (and those it delegated to the regulators) were limited to fixing withdrawal-related deficiencies – for example transferring functions carried out by EU authorities to the regulators – and therefore this exercise did not rationalise or simplify the financial services landscape.[17]

In fact, onshoring further complicated the framework, for example by inserting new powers (for HM Treasury and the regulators) into retained EU law, or in some cases into new secondary legislation that sits alongside retained EU law. Whilst Schedule 3 (Passporting rights) of FSMA was repealed, HM Treasury created a number of transitional regimes for firms exercising EU treaty rights before the end of the transition period, giving them a grace period to apply for permission in the UK or to wind down any remaining business they had.[18] This approach to onshoring was intended to provide stability and continuity in the immediate period after EU exit, but was not designed to be future-proof.[19]

A fragmented rulebook

The volume of EU legislation in recent years combined with onshoring has left what HM Treasury calls a 'fragmented rulebook', with regulatory requirements spread across "*a patchwork of domestic and retained EU legislation, regulator rules made under FSMA and onshored EU technical standards*".[20] Furthermore, the EUWA framework contains a number of constraints that limit HM Treasury's ability to make significant changes to retained EU law. Most notably, direct principal EU legislation (Level 1 regulations) can only be modified by Act of Parliament or specified subordinate powers (such as those contained in EUWA to fix deficiencies).

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[16] Financial Services EU Exit Statutory Instruments, HM Treasury, 15 October 2020: www.gov.uk/government/publications/update-financial-services-eu-exit-statutory-instruments/update-financial-services-eu-exit-statutory-instruments

[17] HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/720298/HM_Treasury_s_approach_to_financial_services_legislation_under_the_European_Union__Withdrawal__Act.pdf

[18] See, for example, The EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018.

[19] Financial Services Future Regulatory Framework Review: Proposals for Reform, HM Treasury, November 2021, p.20: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf

[20] Financial Services Future Regulatory Framework Review Phase II Consultation, HM Treasury, October 2020, p.16.

THE FUTURE REGULATORY FRAMEWORK

The FRF is an attempt to remedy this situation and create a coherent, agile and internationally respected framework for financial services regulation that is right for the UK and reflective of its new position outside the EU.[21] HM Treasury has summarised the objectives for the FRF as follows:

- Clear, coherent and effective allocation of regulatory responsibilities;
- Appropriate policy input by democratic institutions;
- Clearer basis for effective accountability and scrutiny;
- Agile regulatory regime;
- Coherent and more user-friendly regime for end-users; and
- Creating an internationally respected approach.

Before discussing how HM Treasury intends to achieve these objectives, it is worth briefly exploring the remaining international obligations that constrain the UK's discretion to diverge from EU or other jurisdictions' standards.

Constraints: the process of equivalence

The EU-UK Trade and Cooperation Agreement ("TCA") contains limited provision for trade in services generally, or for financial services specifically, mirroring the parties' obligations at the World Trade Organisation level. This follows the EU preference for granting access to EU financial markets on a dossier by dossier basis under a process known as '*equivalence*': the Commission is empowered by EU legislation to deem non-EU frameworks to be equivalent to those in the EU.

The Commission has made only two time limited equivalence decisions in favour of the UK (across the ~15 dossiers that allow for equivalence) and the prospect of further equivalence seems unlikely for the moment.[22] However, HM Treasury inherited these same powers to grant equivalence during onshoring and granted a total of 17 equivalence decisions in favour of the EEA states in November 2020.[23] HM Treasury is also currently negotiating a mutual recognition agreement with Switzerland, with the UK and Switzerland aiming to recognise each other's regulatory and supervisory regimes in the fields of insurance, banking, asset management and capital markets.[24]

Deference

Collectively, equivalence and mutual recognition are referred to as '*deference*' – whereby jurisdictions and regulators defer to each other having assessed their respective regimes. Deference creates a procedural problem. If you move and amend the laws against which you assessed the other jurisdiction's regime, assessing their on-going compliance is more difficult. It also creates the problem that policy changes made whilst rewriting or restating domestic financial services law may change the substantive assessment of equivalence itself.

The UK's freedom to diverge

However, in contrast to other areas of retained EU law where the UK has no legal or practical freedom to diverge, for example if an area falls in scope of the TCA or the Protocol on Ireland/Northern Ireland to the Withdrawal Agreement, the UK is comparatively free to diverge from the structure and substance of EU financial services regulation. Indeed, a number of commentators (and the

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[21] Financial Services Future Regulatory Framework Review: Proposals for Reform, HM Treasury, November 2021, p.4.

[22] The Commission adopted time limited equivalence decisions concerning CCPs (until June 2025) and CSDs (until June 2021); Questions & Answers: EU-UK Trade and Cooperation Agreement, European Commission, 24 December 2020: https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_2532

[23] Guidance Document for the UK's Equivalence Framework for Financial Services, HM Treasury, November 2020: www.gov.uk/government/publications/guidance-document-for-the-uks-equivalence-framework-for-financial-services

[24] Joint Statement between Her Majesty's Treasury and the Federal Department of Finance on deepening cooperation in financial services, 30 June 2020: www.gov.uk/government/news/switzerland-and-uk-to-negotiate-a-bilateral-financial-services-agreement

Taskforce on Innovation, Growth and Regulatory Reform commissioned by the Government) have argued that retained EU law must be rapidly rewritten to create a leaner and more efficient financial services rulebook that is more reflective of the common law.[25] HM Treasury's proposals are reflective of this freedom and in the opinion of the authors represent the most ambitious attempt to rewrite retained EU law that we have yet seen from Government.

A refreshed FSMA architecture: challenges to be addressed

In order to comprehensively restate retained EU law as UK law within the FSMA framework, HM Treasury faces two main law-making challenges:

1. EU law applies more widely than just to FSMA authorised persons (and forcing all firms within the ambit of retained EU law to seek full authorisation would be impractical); and
2. The sheer size of the financial services acquis makes rewriting it through primary or even secondary legislation an extremely onerous task that would take up a huge amount of Parliamentary time and dwarf even onshoring. Of course, HM Treasury also faces a number of political challenges in redesigning financial regulation, but as a (largely) technical exercise, the FRF is interesting in that the challenges for lawmakers may in fact be more significant.

Implementing legislation was announced as part of the Queen's Speech (the Financial Services and Markets Bill) but has not yet been introduced.[26]

While HM Treasury's response to the latest consultation is still to be published, it seems committed to several design principles for the new regime.

Regulator rules

Moving firm-facing requirements into regulator made rules – HM Treasury intends to transfer the vast majority of firm-facing requirements (i.e., provisions imposing direct requirements on firms) into regulator made rules. This will be done by HM Treasury taking a power to repeal retained EU law, which will be exercised once it has been restated in regulator rules. HM Treasury also holds out the prospect of restating some retained EU law in domestic primary or secondary legislation.[27] Setting more specific requirements by regulator made rules would allow them to be amended more easily than by primary or secondary legislation.

Designated Activities Regime ("DAR")

To solve the problem that retained EU law applies more widely than to authorised persons (i.e. the regulators do not have rule-making powers over them), HM Treasury proposes to create a mechanism whereby activities outside the core financial services perimeter are designated and the regulators are empowered to make rules pertaining just to those activities ('designated activities'). HM Treasury provides the example of margin requirements that apply to non-centrally cleared derivative transactions under Regulation (EU) 648/2012 (as it forms part of UK law) – to apply these requirements by regulator rules without a DAR would require market participants to seek authorisation.

Bespoke treatment for FMIs

HM Treasury proposes continued bespoke treatment for FMIs because retained EU law typically requires some sort of registration process which would make them unsuitable for the DAR, but for whom full authorisation might again be overly burdensome.

HM Treasury is therefore aiming to create an architecture to allow for a file-by-file transfer of

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[25] Taskforce on Innovation, Growth and Regulatory Reform commissioned by the Government, Sir Iain Duncan Smith MP (Chair), Theresa Villiers MP & George Freeman MP, May 2021: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994125/FINAL_TIGRR_REPORT__1_.pdf; Restoring UK Law: Freeing the UK's Global Financial Market, Barnabas Reynolds for Politeia, 2021, pp.60–67: www.politeia.co.uk/wp-content/Politeia %20Documents/2021/FEB%20-%20Barney%20Reynolds/Restoring%20UK%20Law%20-%20Freeing%20the%20UK%27s%20Global%20Financial%20Market.pdf?_t=1616000607

[26] New law to protect access to cash announced in Queen's speech, HM Treasury, 10 May 2022: https://www.gov.uk/government/news/new-law-to-protect-access-to-cash-announced-in-queens-speech

[27] Financial Services Future Regulatory Framework Review: Proposals for Reform, HM Treasury, November 2021, p.58.

large parts of the financial services acquis into regulator rules (by way of simultaneous repeal and rulemaking) over a number of years, thereby restating a large majority of retained EU law within the FSMA framework. This necessarily also involves a large transfer of powers recently repatriated from the Commission and ESAs from HM Treasury (and ultimately Parliament) to the regulators; HM Treasury is therefore suggesting a number of control and accountability mechanisms under the FRF.

Accountability

The proposed accountability measures fall into three parts, accountability to stakeholders, Parliament and HM Treasury itself.

Stakeholders and Parliament

Regarding stakeholder accountability, HM Treasury is creating an independent panel to scrutinise and challenge the regulators' cost-benefit analyses (CBAs). It is also seeking to require the regulators to maintain frameworks for reviewing their rules in order to make this process more clear and transparent.[28] Following comments made by parliamentarians during the passage of the Financial Services Act 2021 ("2021 Act"), HM Treasury is also seeking to formalise the regulators' relationship with Parliamentary committees (principally the Treasury Select Committee – "TSC"), including by requiring them to notify TSC of relevant consultations.[29]

Treasury oversight

The most significant accountability measures concern HM Treasury's oversight of the regulators. Some of these – such as a power for HM Treasury to require a regulator to conduct a rule review and the requirement for the regulators to consider the impact of rules and other policies on trade agreements or deference arrangements – are relatively simple in their application.[30]

However, HM Treasury's proposal to apply activity specific 'have regards', which regulators must consider before making rules in that area, is more complex. HM Treasury states that 'have regards' will "*ensure important wider public policy concerns are addressed*" during the rule-making process in specific areas.[31] This will be combined with a power to place obligations on the regulators to make rules in relation to specific areas of regulation.[32]

HM Treasury states that: "I*t would not be possible to use this power to impinge on the regulators' independence by seeking to influence what those rules should be.*"[33] 'Have regards' and obligations are aimed at resolving any tension between the large number of policy choices by the regulators that the restatement process will inevitably require, that would be taken in line with their objectives, and HM Treasury's desire to use the FRF to further the Government's broader financial services reform agenda.

A 'new' secondary objective – 'growth and competitiveness'

More controversially, HM Treasury has also proposed a new 'growth and competitiveness' secondary objective for the regulators.[34] This will mandate the regulators to consider the impact on the UK's competitiveness as a jurisdiction when exercising their functions. Given the FSA was originally required to have regard to maintaining the competitive position of the UK when discharging its responsibilities, which former FCA CEO (and current Governor of the Bank of England) Andrew Bailey linked to the financial crisis, this proposal has faced criticism.[35] Given that regulation has become significantly more rigorous since the financial crisis the authors consider that this concern has been overstated.

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[28] Financial Services Future Regulatory Framework Review: Proposals for Reform, HM Treasury, November 2021, pp.53–55.

[29] Ibid., pp.46-47.

[30] Ibid., pp.40-43.

[31] Ibid., p.65.

[32] Ibid., p.65.

[33] Ibid., p.65.

[34] Ibid., p.33.

[35] Speech on the future of financial conduct regulation, Andrew Bailey, 23 April 2019: www.fca.org.uk/news/speeches/future-financial-conduct-regulation

COMMENT ON THE PROPOSALS

The authors support the proposals but believe that implementing legislation will need careful scrutiny. HM Treasury will need to keep in mind the following points as it seeks to set the framework for and operationalizes the FRF:

- The aim should be to remedy rather than recreate the status quo;
- The need to ensure it has sufficient political direction over the regulators; and
- The need to manage expectations about the extent to which financial services law can be simplified in the initial stages of the FRF.

Remedying the status quo and the lobbying problem

The EU procedure for delegated financial services legislation has flaws that the FRF should seek to remedy. The 'regulatory procedure with scrutiny' procedure (as it is applied to financial services through the ESAs), whereby the Commission adopts technical standards drafted by the ESAs, and which the UK largely copied during onshoring (with HM Treasury replacing the Commission and the regulators replacing the ESAs), is far from perfect.[36]

Firstly, it is naïve to assume that a technocratic process is immune to lobbying and political influence: moving legislative or regulatory responsibilities to independent agencies simply shifts lobbying activity away from Brussels (or Westminster) to that agency's door.[37] Secondly, the opacity and unaccountability of the EU legislative process was much criticised during the EU referendum debates and it would be odd not to seek to remedy this.

It is not yet clear that the FRF will actually address these criticisms. The debates during the passage of the 2021 Act are instructive – for example the comments of Baroness Bowles: "*Government have decided the future. Regulators are indulged, Parliament ignored. The excuse is made that the division of powers is just returning to the original FiSMA 2000 […] but since the financial crisis, there is so much more detailed and complex legislation than there was in 2000, so much more EU, public and parliamentary consultation and scrutiny […] Now the light is switched off, and we fall back on arrogant, secretive policy-making, which is no way to be world-leading in the modern age.*"[38]

The FRF is tinged with more than a hint of nostalgia for the financial regulatory landscape before 2010, which is generally considered to have been inadequate and which was overhauled by the 2012 Act. Further, the regulators are not without criticism for how they exercise their current powers and the FCA in particular has seen several scandals in recent years.[39] With the FRF proposing to delegate a far larger sphere of legislative responsibilities to the regulators, namely the responsibility for amending the majority of financial services law, these issues are amplified.

HM Treasury has recognised this and proposed the accountability measures to Parliament and industry discussed above. However, these have been criticised by a number of organisations as insufficient. An unusual coalition of civil society and industry bodies has united in condemnation.[40] For example, the proposed mechanism whereby HM Treasury can require the regulators to review rules

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[36] Treaty on the Functioning of the European Union, Article 290.

[37] See, for example, Lobbying across venues in EU financial regulation: the role of institutions' demand for information, Elisa Cencig, September 2021: http://etheses.lse.ac.uk/4364/1/Cencig__Lobbying-across-venues-EU.pdf

[38] Hansard, Volume 809: debated on Thursday 28 January 2021: https://hansard.parliament.uk/lords/2021-01-28/debates/077CE6F3-BD76-4D3D-8A47-3E1A38F985E6/FinancialServicesBill

[39] The FCA was recently criticised by the 2020 Report of the Independent Investigation into the collapse of London Capital & Finance.

[40] Future Regulatory Framework for Finance: Civil Society Join Statement, February 2022: https://financeinnovationlab.org/wp-content/uploads/2022/02/FRF-CSO-Joint-Statement-2022.pdf

has been criticised by trade bodies as insufficient.[41] As a commentator observed recently, "*The industry is wary of super-powerful regulators and wants more expert scrutiny of how they're fulfilling their various duties. Civil society groups, in contrast, want more rigorous oversight and greater transparency to counter the might of sector lobbying and elevate the concerns of other stakeholders.*"[42]

In addition, the accountability proposals fall short of what Parliament is likely to demand. The APPG on Financial Markets & Services has suggested a new Parliamentary committee with a specific remit for financial services (as the TSC's remit is much broader than just financial services).[43] Even if the format of Parliamentary scrutiny is ultimately a matter for Parliament, the signs are that the passage of the bill will be difficult, especially in the House of Lords. That industry, civil society groups and parliamentarians are united in criticism of the oversight of the FRF might mean that changes to the accountability measures are required.

Ensuring sufficient political direction over the regulators

Ultimately, the FRF will be judged a success or failure on whether it facilitates or inhibits the Government's broader financial services reform agenda. HM Treasury already has a wide range of powers over the regulators, including to define the scope of the FCA's objectives by secondary legislation and to make recommendations to the FCA about discharging its general duties. [44]

However, HM Treasury lacks the ability to provide specific direction to the regulators in most areas: the regulators work to further a narrow set of objectives and, even with a new competitiveness objective, their focus on consumer protection and financial stability is potentially at odds with industry calls for clear design changes, such as simpler regulation, as part of restatement.[45] Equally, should HM Treasury decide to retain large portions of retained EU law as secondary legislation, this might make the FRF less agile. This choice in turn would defeat the purpose of delegating legislative responsibility to the regulators, and lead to criticism of political interference in a regulatory setup that was recently praised by the IMF for being independent and efficient.[46]

Therefore, HM Treasury's final combination of objectives, 'have regards'/obligations and other tools must strike a careful balance between allowing Government to set the policy agenda and maintaining the regulators' discretion to set the precise requirements applicable to firms.

Managing expectations: what is realistic?

It is important for stakeholders to realise that repeal and restatement of retained EU law will be limited in what it can achieve. The vast body of retained EU financial services law on the statute book means that the project will take years to fully restate retained EU law (unless the regulators and HM Treasury are prepared to divert significant resources to the FRF). HM Treasury's expectation is that regulators will initially replace the repealed provisions with rules that are similar to those in place.[47]

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[41] UK Finance response to consultation from HM Treasury, UK Finance, 8 February 2022: www.ukfinance.org.uk/system/files/UK%20Finance%20response%20to%20FRF%20consultation%20on%20proposals%20for%20reform.pdf

[42] City regulation post-Brexit will need greater accountability, Helen Thomas for the Financial Times, 4 May 2022: www.ft.com/content/c095deef-3bcd-4aaf-b56f-1b112875ced8

[43] The role of Parliament in the Future Regulatory Framework for Financial Services, APPG on Financial Markets & Services, February 2021: https://apgfms.org.uk/wp-content/uploads/2021/02/APPG-FMS-role-of-parliament-in-FS-reg-framework-consultation-report-FINAL-18-feb-21.pdf

[44] Sections 1J and 1JA of FSMA.

[45] City presses for more concessions in UK regulatory reform, Matei Rosca for Politico, 16 November 2021: www.politico.eu/article/city-presses-uk-government-for-more-concessions-on-regulation/; ABI response to the Financial Services Future Regulatory Framework, ABI, 9 November 2021: www.abi.org.uk/news/news-articles/2021/11/abi-response-to-the-financial-services-future-regulatory-framework-review

[46] Financial Sector Assessment Program: United Kingdom, IMF, February 2022, p.68: www.imf.org/-/media/Files/Publications/CR/2022/English/1GBREA2022002.ashx

[47] Financial Services Future Regulatory Framework Review: Proposals for Reform, HM Treasury, November 2021, p.67.

If the regulators are required to fully consult on restatement (as is currently the case when they make rules), this might further incentivise them to limit change so as to simplify the cost-benefit analysis.[48] Unless political direction is applied to particular areas, policy changes are likely to be restricted to better tailoring the financial services rulebook to the UK – for example thresholds are generally quoted in Euros in retained EU law – and other minor changes which were not considered to be deficiencies (and therefore weren't amended as part of onshoring).

So, there is danger of a mismatch between the Government's bullish remarks on cutting red tape in retained EU law and what is likely to happen in practice, which will be more limited. This tension was recognised in a recent speech by the Economic Secretary to the Treasury, who said, speaking of MiFID II, "*we're, of course, very aware of the time, money and effort you've collectively invested in adapting and adhering to MiFID over the years. So, this was never going to be and is not about change for change's sake*".[49] The FCA has made similar pronouncements, commenting that it will seek to "*smooth off some of [MiFID II's] rough edges, and reduce the burden of regulation where possible, but without significantly changing the protection of investors and the protections for market integrity that were built into the legislation*" as part of the FRF.[50]

Low hanging fruit: improving the operation of (or dis-applying) retained EU law

However, low-hanging fruit that the FRF could (and probably will have to) pluck is to improve the operation of retained EU law. EUWA was partly a product of the political difficulties that plagued the May administration and partly a reflection of the legal complexity of leaving the EU. But EUWA – together with the European Union (Withdrawal Agreement) Act 2020 and the European Union (Future Relationship) Act 2020 (which implemented the TCA) – has dramatically complicated the UK legal framework post-exit by creating new categories of UK law and partly maintaining the supremacy of (retained) EU law.

In addition to restricting the amendment of retained EU law (see above), Sections 5 and 6 of EUWA provide that unmodified retained EU law must be interpreted by lower courts in accordance with pre-exit CJEU case law and EU law principles, with only appeal courts having the power to diverge. The practical operation of applying retained EU law was discussed in obiter comments by Green LJ in *Lipton v BA City Flyer*, outlining the long list of factors that courts must consider when reviewing retained EU law.[51] Should the FRF lead to the modification or restatement of the financial services acquis such that it is no longer retained EU law, then the rules in EUWA would likely be disapplied and pre-exit CJEU case law would then only be persuasive[52]. Whilst there is relatively little pre-exit financial services EU case law, this could be an important precedent for modification of retained EU law in other areas.

The FRF will also be a useful precedent for Parliament to provide for Level 1 regulations to be amended by subordinate legislation in a broader range of circumstances (pending their ultimate repeal and restatement) than is currently the case under EUWA.

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[48] Sections 138I and 138J of FSMA.

[49] The Economic Secretary to the Treasury, John Glen's speech at the Association of Financial Markets in Europe, Rt Hon John Glen, 1 March 2022: www.gov.uk/government/speeches/the-economic-secretary-to-the-treasury-john-glens-speech-at-the-association-of-financial-markets-in-europe

[50] Brexit Britain looks to smooth 'rough edges' of Mifid II, James Beech for the IR magazine, 1 February 2022: www.irmagazine.com/regulation/brexit-britain-looks-smooth-rough-edges-mifid-ii

[51] *Lipton v BA City Flyer* [2021] EWCA Civ 454.

[52] Written evidence submitted by Catherine Barnard to the Retained EU Law Inquiry (European Scrutiny Committee), 28 April 2022: https://committees.parliament.uk/writtenevidence/107889/html

CONCLUSIONS

The authors welcome the FRF and commend HM Treasury's proposed approach to redesigning the framework for financial services for its conceptual clarity. However, now the work begins to try and effect these design principles through primary legislation, and later secondary legislation and regulator rules. We will be following the implementation of the FRF closely to see how this vast, multi-year project evolves over time.

For further information on the Society of Conservative Lawyers contact:
The Administrative Secretary, The Lodge, Deaks Lane, Cuckfield RH17 5JB
administrator@conservativelawyers.com
www:conservativelawyers.com

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